# 立法會
# *Legislative Council*

LC Paper No. LS31/15-16

**Paper for the House Committee Meeting**
**on 29 January 2016**

**Legal Service Division Report on**
**Securities and Futures (Amendment) Bill 2016**

## I. SUMMARY

1. **The Bill** The Bill seeks to amend the Securities and Futures Ordinance (Cap. 571) and other enactments to provide for -

(a) the incorporation, registration, management, operation and regulation of open-ended fund companies (OFCs); and

(b) profits tax exemption for OFCs, exemption from stamp duty for transfers relating to the sale or purchase of shares or units of OFCs under specified conditions and other related matters.

2. **Public Consultation** Public consultation on the proposals was conducted in 2014. Respondents were generally supportive of the introduction of a new OFC structure in Hong Kong. Comments received focused mainly on technical issues.

3. **Consultation with LegCo Panel** On 7 April 2014, the Administration briefed the Panel on Financial Affairs on the proposal to introduce a new OFC structure in Hong Kong. Members raised various concerns/enquiries on the proposals.

4. **Conclusion** In view of Members' concerns/enquiries raised at the above Panel meeting, Members may wish to form a Bills Committee to study the Bill in detail.

## II. REPORT

The date of First Reading of the Bill is 27 January 2016. Members may refer to the LegCo Brief (File Ref.: SF&C/1/2/22C(2015)) issued by the Financial Services and the Treasury Bureau on 13 January 2016 for further details.

### Object of the Bill

2. The Bill seeks to amend the Securities and Futures Ordinance (Cap. 571) and other enactments[1] to provide for -

(a) the incorporation, registration, management, operation and regulation of open-ended fund companies (OFCs); and

(b) profits tax exemption for OFCs, exemption from stamp duty for transfers relating to the sale or purchase of shares or units of OFCs and other related matters.

### Background

3. Under the existing law, an open-ended investment fund[2] may be established in the form of a unit trust[3] but not in corporate form due to various restrictions on capital reduction under the Companies Ordinance (Cap. 622).

4. According to paragraph 2 of the LegCo Brief, the Administration considers it necessary to introduce a new OFC structure in response to the market need for a more flexible choice of investment fund vehicle as it will allow funds to be set up in the form of a company, but with flexibility to create and cancel shares for investors to trade the funds, which is currently not enjoyed by conventional companies.

### Key provisions of the Bill

<u>Amendments to Cap. 571</u>

5. To provide for the establishment of OFC under Cap. 571, Clause 6 of the Bill adds a new Part IVA (new sections 112A to 112ZT) to Cap. 571.

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[1] These enactments include the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies (Disqualification Orders) Regulation (Cap. 32I), the Inland Revenue Ordinance (Cap. 112), the Stamp Duty Ordinance (Cap. 117), the Business Registration Ordinance (Cap. 310), the Business Registration Regulations (Cap. 310A), the Resolution of the Legislative Council Establishing Companies Registry Trading Fund (Cap. 430B) and the Contracts (Rights of Third Parties) Ordinance (Cap. 623).

[2] Open-end fund (or open-ended fund) is a collective investment scheme which can issue and redeem shares at any time. An investor will generally purchase shares in the fund directly from the fund itself rather than from the existing shareholders: https://en.wikipedia.org/wiki/Open-end_fund.

[3] Under section 30(2) of the Stamp Duty Ordinance (Cap. 117), the term "unit trust scheme" is defined to mean "any arrangements made for the purpose, or having the effect, of providing, for persons having funds available for investment, facilities for the participation by them, as beneficiaries under a trust, in any profits or income arising from the acquisition, holding, management or disposal of any property whatsoever."

*Definition of "open-ended fund company"*

6. New section 112A contains the definition of "open-ended fund company" which means a collective investment scheme constituted as a corporation that holds a certificate of incorporation issued by the Registrar of Companies (CR) under new section 112C.

*Incorporation and registration*

7. New section 112C provides that a person may apply to CR for incorporation of an OFC. A certificate of incorporation can only be issued after CR has received notification from the Securities and Futures Commission (SFC) that it has registered the proposed company[4] under new section 112D. A person who, without reasonable excuse, carries on business or holds out as an OFC, commits an offence and would be liable on conviction on indictment to a fine of $5,000,000 and to imprisonment for seven years; or on summary conviction to a fine of $500,000 and to imprisonment for two years. In either case, there would be a penalty for a continuing offence (new section 112B).

*Share capital and shareholder's liability*

8. New section 112P provides that shares in an OFC have no nominal value and that the amount of the paid-up share capital of an OFC is at all times equal to the net asset value of the company. New section 112Q provides that the liability of the shareholders of an OFC is limited to any amount unpaid on the shares held by the shareholders.

9. Unlike a company formed under Cap. 622, it is proposed that an OFC would not be subject to the restrictions on the reduction of share capital and those on distribution out of share capital.

*Sub-funds and segregated liability of sub-funds*

10. An OFC may be created as an umbrella fund. New section 112R permits an OFC to divide its scheme property into separate parts and each separate part is a sub-fund of the OFC. Under new section 112S, the assets of a sub-fund belong exclusively to the sub-fund and must not be used to discharge the liabilities of OFC or any other sub-fund of OFC, and any liability incurred on behalf of a sub-fund may only be discharged out of the assets of the sub-fund. It also provides that a sub-fund is not a legal person separate from OFC but its assets may be subject to orders of the court as if it were a separate legal person.

*Key operators*

11. New sections 112U to 112Y relate to directors of OFC, in particular new section 112U provides that a director of an OFC owes the OFC the same

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[4] Under new section 112A, "Proposed company" is defined as a company intended to be incorporated under the new Part IVA.

fiduciary and other duties that are owed by a director of an ordinary company formed and registered under Cap. 622 to the ordinary company.

12. New section 112Z requires that the management of the scheme property of OFC must be delegated to an investment manager who must be an intermediary licensed or registered with SFC for Type 9 regulated activity under Cap. 571. The effect is that the investment manager of OFC, as intermediary licensed or registered with SFC, would be subject to the applicable requirements under the relevant legislation, regulations, codes and guidelines as well as any other regulations applicable to SFC-licensed or registered intermediaries.

13. New section 112ZA requires OFC to have a custodian to whom all the scheme property of OFC must be entrusted for safe keeping. The effect is that the assets of OFC would be segregated from that of the investment manager to avoid potential conflicts of interest.

*Supervision by SFC*

14. The principal regulator of Hong Kong's securities and futures markets is SFC established under the Securities and Futures Commission Ordinance (Cap. 24). Given that OFCs would be set up to function as an investment fund vehicle, the Bill proposes that SFC would be the primary regulator responsible for the registration and regulation of the OFCs under Cap. 571. New sections 112ZF to 112ZJ contain provisions relating to supervision of OFCs by SFC. In particular, new section 112ZF empowers SFC to give directions to OFCs, their investment managers or directors in specified circumstances.

*SFC may make rules, publish codes and guidelines*

15. New sections 112ZK to 112ZM empower SFC to make rules to provide for, among others, the carrying on of collective investments by means of OFCs and the regulation of OFCs, and the rules may prescribe offences and provide for defences to the prescribed offences (new section 112ZN). In addition, new 112ZR empowers SFC to publish codes and guidelines to provide guidance in respect of matters relating to the incorporation, management, operation and business of OFCs.

*Termination and winding up of OFCs*

16. New section 112ZM empowers SFC, with the consent of the Official Receiver (OR), to make rules to provide for the functions of the OR in relation to the winding up and dissolution of OFCs and of sub-funds of OFCs. An OFC may apply to SFC for cancellation of its registration under new 112D upon its termination (new section 112ZH).

17. The Bill also proposes that SFC, as the primary regulator of OFCs, may present a petiton for an OFC to be wound up under the OFC rules[5] if it appears to the SFC that it is desirable in the public interest that the OFC should be wound up (new section 212(1A)). SFC may cancel the registration under new section 112D of the OFC if an order for the winding up of the OFC has been made by the court under the OFC rules (new section 112ZI).

Related amendments

*Profits tax exemption for OFCs*

18. Currently, profits tax exemption is given to public funds and offshore funds under sections 26A and 20AC of the Inland Revenue Ordinance (Cap. 112) respectively. Clause 25 of the Bill amends section 2(1) of Cap. 112 to include the definition of "open-ended fund company". It also amends the definition of "receiver" in that section. The effect is that the existing profits tax exemption regime would apply to OFCs.

*Stamp duty treatment for OFCs*

19. Stamp duty is charged under Stamp Duty Ordinance (Cap. 117) on transfers of Hong Kong stocks. For stamp duty purpose, a unit under a unit trust scheme is included in the definition of stock under section 2(1) of Cap. 117. Clause 29 of the Bill adds a Part IVA to Cap. 117 to provide for the application of certain provisions relating to unit trust schemes in sections 19, 19A, 30, 47A and 47B of Cap. 117 to OFCs. The effect is that the current stamp duty treatments applicable to certain sale or purchase and transfers of units under a unit trust scheme would apply to OFCs.

20. Clauses 27, 30, 31 and 32 of the Bill amend Cap. 117, and Clause 33 of the Bill adds a new Schedule 9 to Cap. 117. The effect of the proposed amendments is that a contract note would not required to be executed or stamped for a transaction relating to sale or purchase of a share or unit of an authorized open-ended collective investment scheme under specified conditions and the transfer that relate to the sale or purchase of such share or unit would be exempt from stamp duty under Cap. 117.

*Business registration*

21. OFC, as an investment fund vehicle in a corporate form, would be required to register for business under the Business Registration Ordinance (Cap. 310). Clause 34 of the Bill includes the definition of open-ended fund company in section 2(1) of Cap. 310, and it also amends certain definitions in that section to cover OFC. Clause 36 expands the scope of section 5A of Cap. 310 to provide for simultaneous business registration applications of OFCs.

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5 Under new section 112A, OFC rules is defined as rules made under new section 112ZK, 112ZL or 112ZM.

**Commencement**

22. The Bill, if passed, would come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

**Public Consultation**

23. According to paragraph 22 of the LegCo Brief, a public consultation exercise on the proposal to introduce the OFC structure was conducted in March 2014. A total of 27 written submissions have been received. Respondents were generally supportive of the proposal and the comments received focused mainly on technical issues.

**Consultation with LegCo Panel**

24. The Clerk to the Panel on Financial Affairs (the Panel) has advised that the Panel was briefed on the proposal to introduce a new OFC structure in Hong Kong at the meeting on 7 April 2014. Members raised concerns/enquiries on some issues, including the structure and regulation of OFCs, permitted investments by OFCs, whether profits tax exemption should be provided to OFCs, and how far the proposal could enhance Hong Kong's competitiveness in attracting overseas funds to domicile in Hong Kong.

**Conclusion**

25. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the Members' concerns/enquiries raised at the above Panel meeting, Members may wish to form a Bills Committee to study the Bill in detail.

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