

# **立法會**

## ***Legislative Council***

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### **Subcommittee on Three Pieces of Subsidiary Legislation Related to the Open-ended Fund Company Regime and Gazetted on 18 May 2018**

#### **Background brief**

#### **Purpose**

This paper provides background information on the Securities and Futures (Amendment) Ordinance 2016 (Commencement) Notice ("Commencement Notice"), Securities and Futures (Open-ended Fund Companies) Rules ("OFC Rules") and Securities and Futures (Open-ended Fund Companies) (Fees) Regulation ("Fees Regulation") (collectively referred to as "the three pieces of subsidiary legislation"), which relate to the implementation of the open-ended fund company ("OFC") regime in Hong Kong. It also gives a brief account of the views and concerns expressed by Members when issues related to the OFC regime were discussed by the relevant committees of the Legislative Council ("LegCo").

#### **Background**

2. Currently, an open-ended investment fund may be established under the laws of Hong Kong in the form of a unit trust but not in corporate form due to various restrictions on capital reduction under the Companies Ordinance (Cap. 622) ("CO"). There have been market calls for a more flexible choice of investment fund vehicle through introducing a new OFC regime in Hong Kong. This will allow investment funds to be set up in the form of a company, but with the flexibility to create and redeem shares for investors to trade the funds, which is currently not enjoyed by conventional companies.

3. Following a public consultation on the relevant legislative proposals conducted in 2014, the Administration introduced into LegCo the Securities and Futures (Amendment) Bill 2016 ("the Bill") in January 2016 to provide a legal framework for the OFC regime. The Bill was enacted as the Securities and Futures (Amendment) Ordinance 2016 ("the Amendment Ordinance") in June 2016.

4. Under the legal framework set out in the Amendment Ordinance, an OFC has characteristics similar to a conventional limited company in that (a) it will have a legal personality; (b) it will have a constitutive document, namely the instrument of incorporation; and (c) it will be governed by a board of directors, and the liability of its shareholders will be limited to the amount unpaid on their shares in the company.

5. Unlike conventional companies, an OFC will have the flexibility to vary its share capital in order to meet shareholder subscription and redemption requests, and may distribute out of share capital subject to solvency and disclosure requirements. It will not be required to be licensed as a licensed corporation under the Securities and Futures Ordinance (Cap. 571) ("SFO"), but will have to be registered with the Securities and Futures Commission ("SFC"), and should delegate its investment management function to an investment manager licensed by or registered with SFC for Type 9 (asset management) regulated activity. The scheme property of an OFC must be entrusted to a custodian, who is separate and independent from the investment manager, for safe keeping.

6. The Amendment Ordinance also sets out the framework for the incorporation and regulation of OFCs and lays down the key structural requirements and the supervisory powers of SFC in respect of OFCs. The operational details of the OFC regime are to be set out in subsidiary legislation (including the OFC Rules and Fees Regulation) and codes.<sup>1</sup> A diagram illustrating the regulatory framework is in **Appendix I**.

### **Three Pieces of Subsidiary Legislation Related to the Open-ended Fund Company Regime**

7. SFC conducted a public consultation in 2017 on the draft OFC Rules, draft OFC Code and the proposed fees chargeable by the authorities in respect of the OFC regime. According to the Administration, SFC received generally positive feedback. On 18 May 2018, the three pieces of subsidiary legislation were published in the Gazette. They were tabled before LegCo on 23 May 2018 and are subject to the negative vetting procedure.

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<sup>1</sup> According to the LegCo Brief, the Code on Open-Ended Fund Companies ("OFC Code") will be made by SFC under the new section 112ZR of SFO. Like other codes issued under SFO, the OFC Code will be non-statutory. Under the new section 112ZS, failure by any person or OFC to comply with the OFC Code shall not by itself render the person or OFC liable to any judicial or other proceedings. However, failure by the investment manager of an OFC to comply with the OFC Code may cause SFC to consider whether such failure adversely reflects on the investment manager's fitness and properness to remain licensed or registered.

## Securities and Futures (Amendment) Ordinance 2016 (Commencement) Notice

8. The purpose of the Commencement Notice is to appoint 30 July 2018 as the date on which the Amendment Ordinance, and thus the OFC regime, comes into operation. The OFC Rules and Fees Regulation will also come into operation on the same day.

## Securities and Futures (Open-ended Fund Companies) Rules

9. The OFC Rules set out the detailed statutory requirements concerning an OFC's formation and maintenance, appointment and cessation of appointment of key operators of an OFC (i.e. the directors, investment manager and custodian), the functions of the Registrar of Companies ("RC") (primarily in respect of incorporation and corporate filings), the segregated liability feature of sub-funds of OFCs,<sup>2</sup> winding-up, and offences.

## Securities and Futures (Open-ended Fund Companies) (Fees) Regulation

10. The Fees Regulation sets out the fees charged by SFC for privately offered OFCs and the fees charged by RC for all OFCs.<sup>3</sup> Taking into account the current fees applicable to companies incorporated under CO as well as overseas practices, privately offered OFCs only need to pay minimal registration fees, and fees for changes that require SFC's approval. They do not need to pay annual fees after registration with SFC. The OFC-related fees chargeable by RC are set on the basis of full cost recovery in accordance with the established policy. They are largely the same as the current fees applicable to companies incorporated under CO, with four of them adjusted to meet the cost recovery principle.

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<sup>2</sup> The new section 112R of SFO provides that an OFC may divide its scheme property into separate parts, with each part forming a sub-fund. An OFC may also be created as an umbrella fund meaning that the OFC can consist of a number of separately pooled sub-funds and each sub-fund will have a pool of assets that is managed in accordance with the investment objectives and policies for that particular sub-fund.

<sup>3</sup> According to the LegCo Brief, in respect of the fees chargeable by SFC, no new fees will apply to publicly offered OFCs. In other words, these OFCs will only have to pay the existing application and authorization fees applicable to publicly offered funds seeking SFC's authorization, as well as post-authorization annual fees. As these fees have already been set out in Schedule 1 to the Securities and Futures (Fees) Rules (Cap. 571AF), no separate fees regulation needs to be made for publicly offered OFCs.

## **Major views and concerns expressed by Members**

11. The Panel on Financial Affairs discussed the proposed subsidiary legislation/codes relating to the OFC regime at the meeting on 5 June 2017. The Bills Committee formed to scrutinize the Bill held three meetings from February to April 2016. The major views and concerns expressed by Members are summarized in the ensuing paragraphs.

### Registration and incorporation

12. Members enquired about the operational procedures of the one-stop company incorporation and business registration regime,<sup>4</sup> in particular whether SFC would register a proposed OFC before all the requirements for registration were met. There were also views from the funds industry that the process for setting up privately offered OFCs should be streamlined to optimize the time to launch such OFCs in the market.

13. SFC advised that it would not register a proposed company as an OFC before it was satisfied that the applicant would fulfill all the registration requirements upon incorporation. The following procedures would be adopted:

- (a) SFC would be the sole recipient of and review all application documents, including those to be provided to RC (for incorporation) and the Inland Revenue Department (for business registration);
- (b) once SFC was satisfied that the proposed company was capable of meeting the registration requirements and decided to register it as an OFC, it would forward a notice of registration, together with the relevant documents and fees, to RC; and
- (c) RC would incorporate the proposed company if it was satisfied that the requirements for incorporation had been met. The registration of the proposed company would take effect on the day RC issued the certificate of incorporation.

14. The Administration advised that it would consider how to further streamline the one-stop process when preparing the draft OFC Rules and OFC Code. In addition, SFC and RC would publish the general processing time in handling relevant applications for the industry's reference.

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<sup>4</sup> Under the new sections 112C and 112D of SFO, an OFC will be established by obtaining a registration from SFC and a certificate of incorporation from RC. Procedure-wise, this will be done via a one-stop approach whereby SFC will notify RC of the OFC's registration, and SFC's registration will take effect upon the issuance of a certificate of incorporation by RC. The one-stop approach seeks to simplify the establishment process of OFC, and is expected to enhance efficiency and provide cost savings to the applicant.

### Offering of shares

15. Members noted that OFC share offerings would be made under an offering document. As only the offering documents of publicly offered OFCs (but not privately offered OFCs) would be subject to SFC's authorization, Members expressed concern about possible circumvention of the regulatory requirements applicable to publicly offered OFCs by claiming a fund to be or disguising it as a privately offered OFC.

16. The Administration emphasized that various measures were in place to prevent abuse of the exemption applicable to privately offered OFCs, such as subjecting an offer to no more than 50 persons and a small-scale offer to restrictions under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO"), and imposing pre-sale registration requirements for all OFCs and point-of-sale obligations on intermediaries selling the shares. SFC would investigate into complaints and suspected non-compliance, and take enforcement action as appropriate. If disputes arose as to whether an OFC was privately offered or otherwise, it would be for the court to decide having regard to the circumstances of individual cases.

### Key operators

#### *Directors' legal responsibilities*

17. As directors of OFCs would not be required to be licensed under SFO, Members enquired how the directors could be held responsible for the affairs of the OFCs and sanctioned for failing to perform their duties.

18. The Administration responded that, similar to the conventional company model, the directors of an OFC would be subject to statutory and fiduciary duties. Where SFC discovered that a director of an OFC had committed an offence under the relevant provisions in SFO or engaged in defalcation, fraud, misfeasance or other misconduct, SFC could exercise enforcement powers, including taking prosecution action and/or applying to the court for a wide range of remedial orders. An OFC director would be criminally liable if he/she engaged in fraudulent or deceptive activities, or had colluded with the investment manager in such contraventions. Moreover, pursuant to the established common law, where a director of a company was in breach of his/her duties, he/she might be subject to civil liabilities.

#### *Appointment, resignation and removal of investment manager*

19. Members enquired about the mechanism to be put in place to ensure the proper maintenance of an OFC's investment management function in the event

of a succession gap arising from the resignation or removal of the investment manager of the company, including whether the Administration would consider requiring that at least two investment managers should be appointed for each OFC to reduce the risk of a succession gap.

20. The Administration advised it was incumbent upon the board of an OFC to oversee the company's compliance with the regulatory requirements, including that an investment manager was duly appointed at all times. If an existing investment manager tendered a resignation or was to be removed, the OFC board should procure proper appointment of a new investment manager. The OFC Code would provide for the basic requirements concerning the appointment and removal of an OFC's investment manager. The Administration considered it not necessary to further require appointment of at least two investment managers for an OFC lest it would unduly increase the OFC's operational costs.

#### Segregated liability feature of sub-funds

21. Members sought details on how the segregated liability feature of sub-funds of umbrella OFCs would be implemented. The Administration advised that the proposed OFC Rules would set out certain terms to be included in contracts and transactions entered into by an umbrella OFC as well as certain disclosure requirements for such an OFC. Such requirements would be in line with those for similar corporate fund vehicles in major overseas fund jurisdictions.

#### Termination and winding up

##### *Termination*

22. Members enquired about the triggering mechanism for termination of solvent OFCs, including which parties might apply for the termination, whether the consent of other relevant parties had to be sought and if so, the arrangement in case of disagreement on the termination.

23. The Administration responded that the triggering mechanism and parties who might apply for streamlined termination of an OFC would be laid down in the OFC Code and set out in the OFC's instrument of incorporation. Generally speaking, the OFC board was expected to be the primary party to apply for streamlined termination of the company. Once the OFC assets had been fully distributed to shareholders and all liabilities had been settled, the OFC board could submit relevant documents to SFC and apply for cancellation of the OFC's registration. SFC might refuse the application if it considered that the cancellation would not be in the interest of the shareholders, or if it was in the public interest that any matter concerning the company should be investigated before its registration was so cancelled.

### *Winding up*

24. Members noted that the relevant trades had expressed concerns that it was unclear as to what extent the provisions under CWUMPO were applicable to OFCs. The Administration explained that similar to companies formed under CO, winding up of OFCs, whether solvent or insolvent, would be by way of a winding-up process similar to that under CWUMPO. Provisions in CWUMPO that were considered relevant to OFCs were either set out directly in the Bill or would be clearly set out/referred to in the OFC Rules, with relevant modifications as appropriate.

25. According to the LegCo Brief, in the course of drafting the OFC Rules, it has come to the Administration's attention that due to technical issues over the adequacy of the enabling provisions under SFO, it was not achievable to incorporate the relevant provisions in CWUMPO (with appropriate modifications) in the OFC Rules. In order that the OFC regime can be established without delay, the Administration has adopted a phased approach in laying down the winding-up provisions applicable to OFCs. In the current phase, OFCs will be subject to the provisions relating to disqualification orders and court winding-up process under CWUMPO as an "unregistered company" thereunder. They can also be wound up under the voluntary winding-up process in the OFC Rules. In the next phase, the Administration plans to further amend the law to lay down the necessary enabling provisions to enable the winding up of OFCs to be effected in the same manner as conventional companies.

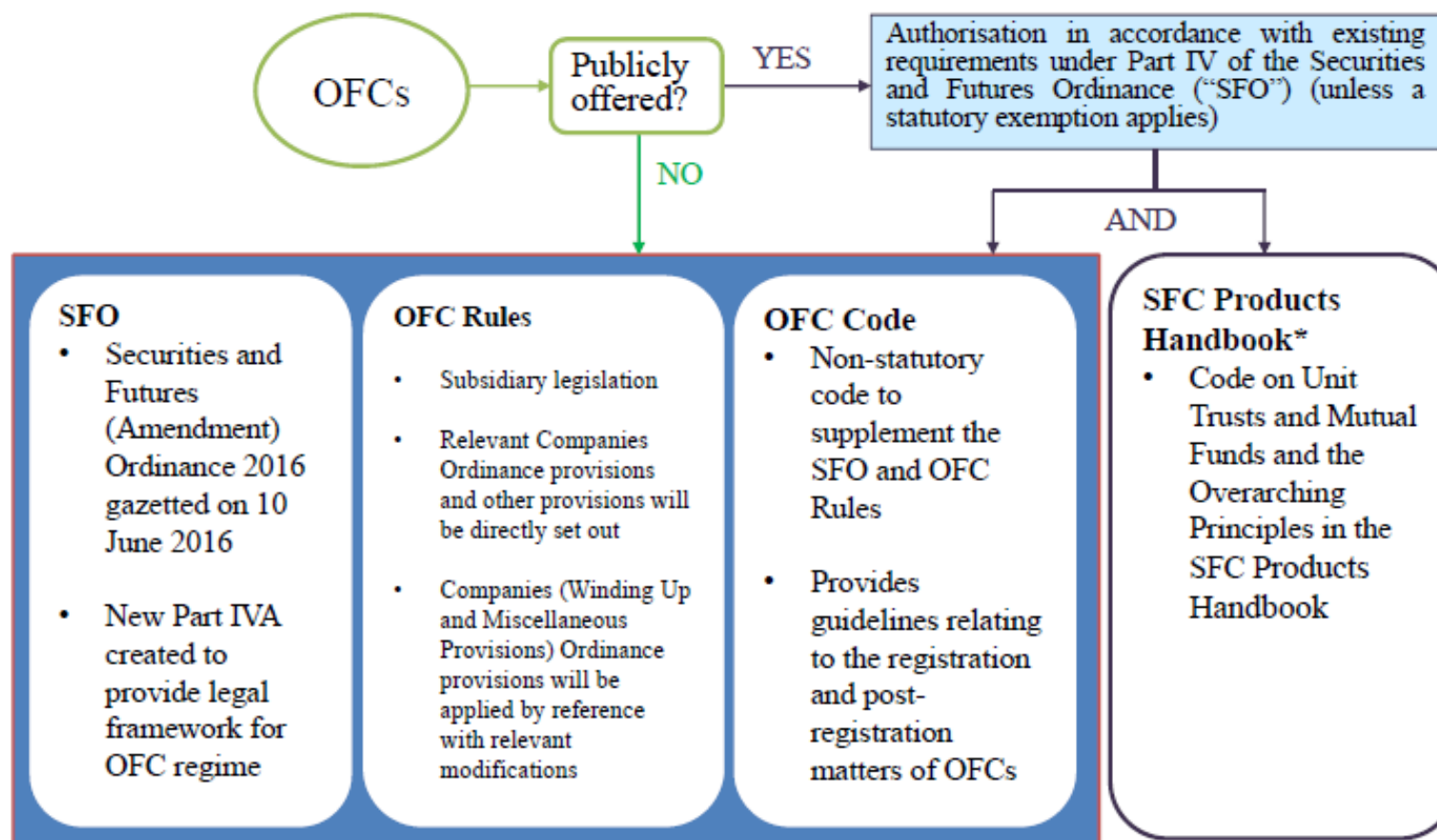
### **Latest development**

26. At the House Committee meeting on 25 May 2018, Members agreed to form a subcommittee to study the three pieces of subsidiary legislation.

### **Relevant papers**

27. A list of relevant papers is set out in **Appendix II**.

## General Regulatory Framework for Open-ended Companies ("OFCs")



\* SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Product

[Source: Annex A to the paper provided by the Administration for the meeting of the Panel on Financial Affairs on 5 June 2017 (LC Paper No. [CB\(1\)1030/16-17\(06\)](#)).]



**Subcommittee on Three Pieces of Subsidiary Legislation Related to the  
Open-ended Fund Company Regime and Gazetted on 18 May 2018**

**List of relevant papers**

<b>Date</b>	<b>Event</b>	<b>Paper</b>
7 April 2014	Meeting of Panel on Financial Affairs	Administration's paper on "Proposal for open-ended fund companies: initiatives to develop the asset management industry" (LC Paper No. <a href="#">CB(1)1180/13-14(05)</a> )  Minutes of meeting (LC Paper No. <a href="#">CB(1)1996/13-14</a> )  Administration's follow-up paper (LC Paper No. <a href="#">CB(1)1316/13-14(02)</a> )
15 January 2016	Securities and Futures (Amendment) Bill 2016 ("the Bill") was introduced into Legislative Council	<a href="#">The Bill</a>  Legislative Council Brief ( <a href="#">File Ref: SF&amp;C/1/2/22C(2015)</a> )  Legal Service Division Report (LC Paper No. <a href="#">LS31/15-16</a> )
February to April 2016	Bills Committee on Securities and Futures (Amendment) Bill 2016	Report of the Bills Committee (LC Paper No. <a href="#">CB(1)896/15-16</a> )
2 June 2016	The Bill was passed by Legislative Council	<a href="#">Bill passed</a>
5 June 2017	Meeting of Panel on Financial Affairs	Administration's paper on "Subsidiary Legislation and Code Relating to the Open-ended Fund Company Regime" (LC Paper No. <a href="#">CB(1)1030/16-17(06)</a> )  Minutes of meeting (LC Paper No. <a href="#">CB(1)1356/16-17</a> )  Administration's follow-up paper (LC Paper No. <a href="#">CB(1)1191/16-17(02)</a> )

<b>Date</b>	<b>Event</b>	<b>Paper</b>
23 May 2018	Securities and Futures (Amendment) Ordinance 2016 (Commencement) Notice, Securities and Futures (Open-ended Fund Companies) Rules, and Securities and Futures (Open-ended Fund Companies) (Fees) Regulation were tabled at Legislative Council	Legislative Council Brief ( <a href="#">File Ref: ASST/3/1/6C</a> )  Legal Service Division Report (LC Paper No. <a href="#">LS61/17-18</a> )

**Hyperlink to relevant document:**

<b>Organization</b>	<b>Document</b>
Securities and Futures Commission	<a href="#">Consultation Conclusions on Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies</a>

**Hyperlinks to relevant Council Question:**

<b>Date</b>	<b>Council Question</b>
16 April 2014	<a href="#">Press release</a> on Council question (written) raised by Hon Kenneth LEUNG