

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

**Response to follow-up actions
arising from the discussion at the meeting on 8 June 2018**

This paper sets out the responses of the Government and the Securities and Futures Commission (“SFC”) to the issues raised by Members in relation to the open-ended fund company (“OFC”) regime at the meeting of the Subcommittee on 8 June 2018.

**Additional requirements to be imposed on investment managers of
OFCs**

2. The investment manager of an SFC-authorised publicly-offered OFC will be subject to the same obligations as the investment managers of all other SFC-authorised publicly-offered investment funds constituted in other legal forms (e.g. in unit trust form). These obligations are set out in the Code on Unit Trusts and Mutual Funds (“UT Code”) and the Overarching Principles Section of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (“SFC Products Handbook”). The SFC Products Handbook sets out the SFC’s authorisation and post-authorisation requirements applicable to publicly-offered investment funds in Hong Kong.

3. In addition, the investment manager of an OFC needs to comply with the legal and regulatory requirements applicable to OFCs, including the Code on Open-ended Fund Companies (“OFC Code”). The OFC Code sets out some basic general principles and requirements which the investment manager, being a key operator of the OFC, has to comply with. These are in line with the corresponding requirements under the UT Code. For example, under the OFC Code, the investment manager is required to carry out the investment management functions of an OFC in accordance with the OFC’s instrument of incorporation and investment management agreement, and in the best interests of the OFC and its shareholders.

4. The above requirement in the OFC Code is consistent with the UT Code, whereby an investment manager is required to manage a fund in accordance with the fund’s “constitutive documents” and in the best interests of the holders of the fund. The requirement in the OFC Code

has the effect of clarifying that the “constitutive document” referred to in the context of an OFC is the instrument of incorporation.

5. As a person licensed by or registered with the SFC to carry out Type 9 regulated activity (“RA9 licensee”), the investment manager of an OFC is subject to the same regulatory requirements applicable to other investment managers of SFC-authorised publicly-offered funds who are RA9 licensees, including the requirement to comply with the Fund Manager Code of Conduct.

Winding-up of OFCs and conventional companies

6. The provisions for an OFC’s voluntary winding-up are set out in the OFC Rules. Such provisions mirror the equivalent voluntary winding-up provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap.32) (“CWUMPO”) for conventional companies and are therefore largely the same, including the grounds for commencing a voluntary winding-up. The key differences are that in the OFC Rules –

- (a) the SFC has been added as a party (in addition to shareholders and creditors) who (i) may apply to the court to have questions arising from the winding-up determined by the court (rule 180), and (ii) will be notified by the liquidator as to his/her summoning of a general meeting for laying of an account of conduct of the winding-up of an OFC (rule 189). Such additions are made in line with the SFC’s role as the primary regulator of OFCs;
- (b) the investment manager and custodian of an OFC have been added to the list of persons who are disqualified from being appointed as a provisional liquidator or liquidator of an OFC; a person who has acted in that capacity in the past two years would need to disclose that relationship when making a disclosure statement for the purpose of his/her intended appointment as a provisional liquidator or liquidator of an OFC (rule 182). This is consistent with the general policy intent with the equivalent provision in the CWUMPO which generally forbids persons having a potential conflict of interest to be a company’s liquidator or provisional liquidator; and
- (c) provisions have been provided to enable sub-funds of an

OFC to be wound up voluntarily in the same manner as an OFC (rule 188).

7. An OFC may also be wound up by way of court winding-up directly under the CWUMPO, as it falls within the definition of an “unregistered company”¹ in the CWUMPO where it has eight or more shareholders. There is thus no difference in the court winding-up of an OFC as an unregistered company under the CWUMPO as compared with other unregistered companies under the CWUMPO.

8. As compared with a conventional company incorporated pursuant to the Companies Ordinance (Cap. 622) (“CO”), the key difference in court winding-up provisions from unregistered companies (including OFCs) is that the grounds for winding-up for conventional companies under Part V are wider than that of unregistered companies. Details can be found in paragraphs 9 to 11 below. Otherwise, the provisions for court winding-up of unregistered companies and conventional companies are the same.

9. An unregistered company may be wound up by the court on the grounds that –

- (a) the company is dissolved or has ceased to carry on business;
- (b) the company is unable to pay its debts; and
- (c) the court is of the opinion that it is just and equitable.²

10. In addition to the grounds at paragraph 9(b) and (c) above, a conventional company may be wound up by the court on the following grounds –

- (a) the company has by special resolution resolved that the company be wound up by the court;
- (b) the company does not commence its business within a year or suspends its business for a whole year;

¹ Section 326(1) of the CWUMPO.

² Section 327(3) of the CWUMPO.

- (c) the company has no members; and
- (d) in accordance with its articles.³

11. The Registrar of Companies (“the Registrar”) may also petition for court winding-up of a conventional company in cases where the company is being carried on for an unlawful purpose, where it does not have sufficient number of directors according to the requirements under the CO, failure to pay relevant fees or is persistently in breach of its specified obligations under the CO.⁴

SFC’s power to override OFC board’s decisions or seek remedies

12. Under section 214A of the Securities and Futures Ordinance (Cap.571) (“SFO”)⁵, the SFC may petition to the Court of First Instance for an order if it appears to the SFC that at any time since the incorporation of an OFC, the business and affairs of the OFC have been conducted in a manner –

- (a) oppressive to its shareholders or any part of its shareholders;
- (b) involving defalcation, fraud, misfeasance or other misconduct towards its shareholders or any part of its shareholders;
- (c) resulting in its shareholders or any part of its shareholders not having been given all the information with respect to its business or affairs that they might reasonably expect; or
- (d) unfairly prejudicial to its shareholders or any part of its shareholders.

On such application by the SFC, the Court may make various orders.

³ Section 177(1) of the CWUMPO.

⁴ Section 177(2) of the CWUMPO.

⁵ To come into effect when the Securities and Futures (Amendment) Ordinance 2016 (“the Amendment Ordinance”) comes into operation. Currently, the Securities and Futures (Amendment) Ordinance 2016 (Commencement) Notice appoints 30 July 2018 as the date on which the Amendment Ordinance commences.

These orders include an order restraining the carrying out of an act pursuant to a resolution passed and any order the Court considers appropriate for regulating the conduct of the business or affairs of the OFC in the future, including an order for the alteration of the instrument of incorporation of an OFC.⁶

13. Section 214A is modelled after the existing section 214 of the SFO. Regarding section 214, examples provided by case law as to unfairly prejudicial conduct to shareholders of a company include fraud and conduct that takes the form of neglect or inaction on the part of those to whom the affairs of a company are entrusted.⁷

14. Separately, where the terms and conditions of an instrument of incorporation, board resolution or offering document contravenes the SFO, the OFC Rules or the OFC Code⁸, the SFC may make an application under section 213 of the SFO for a court order restraining or prohibiting the occurrence of the contravention. For example, there are certain mandatory provisions for an instrument of incorporation under section 112K of the SFO. Where the instrument of incorporation contains a term which is inconsistent with such mandatory provision or the board passes a resolution which makes the OFC act in a manner contravening such mandatory provision, the SFC may apply for a court order to restrain such contravention.

15. The SFC may also impose a registration condition on the OFC for its offering documents to be updated with reference to the terms of the court order granted pursuant to section 213 or 214A of the SFO, for example to remove disclosures concerning measures of an OFC which are found to be unfairly prejudicial or in contravention of the statutory or regulatory requirements.

⁶ Section 214A and section 214B of the SFO.

⁷ In the *Styland Holdings Limited and China Asean Resources* case in 2012, on an application by the SFC under section 214 of the SFO, the Court ordered former senior officers of the companies to pay compensation to their former companies in respect of their misconduct in relation to unauthorised transactions which were not in the companies' interests. In both cases, the Court accepted that the payments amounted to misappropriation of company assets which caused unfair prejudice to the company and its shareholders.

⁸ Compliance with the OFC Code is expected to be one of the registration conditions for an OFC. A breach of a registration condition is also a ground for the SFC to apply for a court order under section 213 of the SFO.

Compulsory redemption of OFC shares

16. The constitutive or offering documents of an investment fund may provide for certain specific circumstances in which a compulsory redemption may be made. Such circumstances typically include where an investor would be in breach of relevant laws and regulations by holding interests in the fund, or the holding of such interests by the investor may result in adverse tax consequences on the fund as well as other investors. The same would apply to OFCs.

17. In considering the acceptability of a constitutive or offering document of an OFC which provides for compulsory redemption in certain circumstances, the SFC may have regard to whether such provision may contravene applicable legal and regulatory requirements, including whether it may constitute a case of unfair prejudice to shareholders under section 214A of the SFO.

Common law privilege against self-incrimination

18. Rule 49 of the OFC Rules is modelled on sections 865 and 876 of the CO. The rule seeks to strike a reasonable balance between the exercise of the Registrar's power of enquiry and the rights of the person who is the subject of the enquiry. As the Registrar has no other power of investigation in respect of a false statement in the documents provided to the Registrar under Part IVA of the SFO, it is of crucial importance that the Registrar has adequate power to ask the person who is the subject of the enquiry to provide the necessary answers to the enquiry. Otherwise, the Registrar's power of enquiry would be stultified.

19. For the same reason, section 876 of the CO provides that if the Registrar (or a delegate of the Registrar) requires a person under section 873 to provide any information or explanation in respect of any record or document produced, the Registrar or the delegate must ensure that the person has first been informed or reminded that the requirement to provide the information or explanation, as well as the information or explanation provided by the person, are not admissible in evidence against the person in criminal proceedings (other than those in relation to false statement or for perjury). If such person makes a claim of tendency to incriminate, the information or explanation will not be admissible against him in criminal proceedings (except those specifically referred to in subsection (2)). The operation of section 876 is confined to an offence in relation to the making of a false statement.

20. We understand that it is well-established that the exercise of investigation power at the investigation stage does not infringe a person's right against self-crimination. This is because the right is relevant only where a criminal charge is laid and the prosecution seeks to introduce self-criminating evidence in the course of a criminal trial (see *Saunders v UK* [1996] 23 EHRR 313 and *R v Hertfordshire County Council ex p. Green Environmental Industries* [2000] 2 AC 212). As laid down in the judgment of the case of *Koon Wing Yee v The Securities & Futures Commission*, CACV 369/2007: "... there was nothing in the Bill of Rights which gave a person protection from legislation requiring him, on pain of penalty, to answer questions put by an investigating authority".

21. Indeed, the requirement in rule 49 that the person must first be informed of the limitations imposed by rule 49(2) and 49(3) has given the relevant person an added protection in case the information or explanation in question has to be produced in criminal proceedings.

22. Similar provisions can be found in a number of ordinances, including section 187 of the SFO, section 34ZZE of the Mandatory Provident Fund Schemes Ordinance (Cap. 485), section 15 of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615), and section 33H of the Payment Systems and Stored Value Facilities Ordinance (Cap. 584).

Registration of privately-offered OFCs

23. The OFC regime and regulatory framework received general support in the public consultations of 2014 and 2017. The legal and regulatory requirements in the OFC regime are intended to lay down the same basic or minimum operational requirements applicable to all OFCs with reference to an OFC's corporate nature as well as international regulatory practices and standards. Our approach in imposing certain essential regulatory requirements to privately-offered OFCs is broadly in line with the approach in overseas fund jurisdictions such as the UK, Ireland and Luxembourg.

24. Where the basic requirements in the OFC Code are met, other matters in respect of the operation of privately-offered OFCs will remain largely governed by the OFCs' individual constitutive and offering documents (these include, for example, its investment and borrowing strategy, dealing intervals and fees). A more streamlined approach also applies with regards to approval matters of privately-offered OFCs as

opposed to publicly-offered OFCs (for example, the offering documents and scheme changes of privately-offered OFCs would not require the SFC's prior approval). In contrast, publicly-offered OFCs would in addition to the OFC regulatory regime be subject to more extensive requirements under the UT Code. This is consistent with other SFC-authorised publicly-offered funds.

25. The filing requirements for OFCs with the Companies Registry are for basic corporate transparency purpose in view of their limited liability nature. Such filing requirements are in line with those existing requirements for private conventional companies under the CO but are streamlined for the purpose of OFCs. For example, OFCs would not be required to file notice of alteration of share capital, return of allotment, return of share redemption or buy-back, and annual return.

26. Where a private fund opts for the OFC structure instead of a unit trust structure, while it would be subject to the registration process and the basic requirements as set out in the OFC-related laws and regulations, it would also be able to benefit from the profits tax exemption provided by the Inland Revenue (Amendment) (No.2) Ordinance 2018.⁹ As the corporate fund structure is generally popular internationally, offering a private OFC structure provides an additional choice for the fund industry in Hong Kong.

27. In considering the regulatory framework for privately-offered OFCs, we are cognizant of the need to take a measured approach having regard to international regulatory practices and standards, including fundamental International Organisation of Securities Commissions principles in regulating collective investment schemes.

**Financial Services and the Treasury Bureau
Securities and Futures Commission
Companies Registry
Official Receiver's Office
11 June 2018**

⁹ The profits tax exemption will commence at the same time as the OFC regime, i.e. on 30 July 2018.