Proskauer

An Overview of Open-ended Fund Companies in Hong Kong and Practical Tips for Registering an OFC

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1. **What is an open-ended fund company ("OFC")?**

An OFC is a collective investment scheme structured as a separate legal entity in the form of a company with variable capital established under Part IVA of the Securities and Futures Ordinance of Hong Kong ("**SFO**"). The OFC regime which took effect on 30 July 2018, allows investment funds to be set up in the form of a company in Hong Kong, but with the flexibility for investors to trade the funds through creation and cancellation of shares. OFCs are not subject to the restrictions under the Hong Kong Companies Ordinance regarding capital reduction and distribution out of capital that apply to companies limited by shares incorporated under that Ordinance. Investors can subscribe for and redeem shares in the OFCs and distributions can be paid out of net assets or capital. Any restrictions on redemption should be specified in the instrument of incorporation (the constitutive document of an OFC).

OFCs can be classified into public OFCs which are offered to the public, and private OFCs which are privately offered. An OFC can be a single fund or an umbrella fund with sub-funds, and each sub-fund enjoys segregated liability whereby properties of each sub-fund are only available to that particular sub-fund.

In addition to the SFO, other parts of the regulatory framework of OFCs include the Securities and Futures (Open-ended Fund Companies) Rules ("**OFC Rules**") and the OFC Code issued by the Securities and Futures Commission ("**OFC Code**").

As of 12 July 2022, around 230 OFCs have been registered with the SFC.

2. **Key personnel of an OFC**

Key personnel of an OFC include the directors of the OFC, the investment manager, the custodian and the auditor.

Directors

There must be a minimum of two directors on the board of an OFC, at least one of whom must be independent, i.e. not a director or employee of the custodian. Each of them must have the experience and expertise that are appropriate for carrying on the business of the OFC.

It is recommended that before submitting the registration application of an OFC, due diligence checks on each of the directors should be carried out on his/her qualifications, work experience, licensing status etc. and, in particular, breaches of any company, securities or financial markets laws and regulations, fraud or other misfeasance, or whether he/she has been disciplined by or disqualified from any professional body. For directors who have committed any such breaches, the applicant will need to demonstrate to the SFC how these past breaches are not relevant to the discharge of that individual's duties as a director of the OFC.

Investment manager

The OFC must delegate the investment management function to an investment manager and must appoint an investment manager who is registered or licensed for Type 9 (asset management) regulated activity under the SFO. The investment manager must be, and must remain, fit and proper at the time of and after registration of the OFC, and must have sufficient experience, expertise and competence in managing the asset types in which the OFC will invest. The investment manager must fulfil its duties and functions in compliance with applicable laws and regulations and codes of conduct prescribed under the SFO.

Custodian

Every OFC must appoint a custodian for safekeeping of its assets. For a public OFC, the custodian must comply with the same requirements as to the type of entities and capital requirements as those under the Code on Unit Trusts and Mutual Funds ("**UT Code**"). For private OFCs, in addition to custodians qualified under the UT Code, a custodian can also be a licensed corporation or registered institution licensed or registered for Type 1 regulated activity under the SFO which meets the relevant eligibility criteria under the OFC Code.

The custodian must also discharge its statutory duties to take reasonable care, skill, and diligence to ensure the safekeeping of the scheme property of the OFC that is entrusted to it, including proper segregation of assets. It should possess sufficient experience, expertise and competence in safekeeping and recordkeeping of assets in which the OFC invests.

The custodian should also maintain internal control measures in respect of the OFC. For public OFCs, the standard of the applicable measures should be the same as those under the UT Code, whereas for private OFCs, the directors of the custodian should be responsible for the adequacy of the custodian's internal controls which should be commensurate with the nature, scale, complexity and underlying investments of the OFC. In the registration application process of an OFC, the SFC will request a list of internal control measures which will be adopted by the OFC.

Auditor

An OFC must appoint an auditor to carry out annual audits of the OFC. The auditor must be independent of the directors of the OFC, the investment manager and the custodian.

3. **Key operative documents**

The instrument of incorporation is the key constitutive document of an OFC and is binding on the OFC's officers, custodian and shareholders. An Instrument of incorporation must contain certain mandatory provisions prescribed by the SFO, the OFC Rules and the OFC Code, including: the objects of the OFC and types of property in which it will invest; statements that the company is an open-ended fund company with variable share capital, that the amount of its paid-up capital is at all times equal to its net asset value, that shareholders are not liable to the debts of the company, and that the company's scheme property is entrusted to a custodian for safekeeping in compliance with the law; procedures for meetings; circumstances and procedures for removal and cessation of office of directors; procedures and requirements for appointment and removal of auditors; and circumstances and procedures for the termination of the OFC and distribution of assets etc.

The SFC provides indicative templates of instruments of incorporation for both public and private OFCs including the mandatory provisions. The OFC may include additional provisions and also choose not to include non-mandatory provisions from the templates, subject to compliance with applicable laws and regulations.

Other key operative documents include offering documents which must comply with the baseline disclosure requirements under the OFC Code (public OFCs should also comply with those in the SFC Products Handbook). Private OFCs must also disclose the investment scope and restrictions, material risks specific to the type and nature of assets in which the OFC invests.

The OFCs must also enter into an investment management agreement and a custodian agreement governing the terms of appointment of the investment manager and the custodian respectively.

4. **Re-domiciliation of overseas corporate funds to Hong Kong**

The SFO provides also a mechanism to facilitate the re-domiciliation of overseas corporate funds to Hong Kong using the OFC structure. The SFC may register the overseas corporate fund as an OFC provided that it satisfies the prescribed requirements for an OFC, including those relating to the name of the OFC, the registered office, the directors, the investment manager and the custodian. Following registration with the SFC, the fund may apply to the Registrar of Companies for the issue of a certificate of re-domiciliation. Upon re-domiciliation, the fund becomes and continues as a body corporate as a re-domiciled OFC. The effect of the re-domiciliation is neither to create a new legal entity, nor to prejudice or affect the identity or continuity of the fund registered in its place of incorporation; nor will it affect any existing contracts, property, rights, privileges, obligations or liabilities of, nor any existing legal proceedings commenced by or against, the re-domiciled fund.

5. **Key advantages of establishing a fund under the OFC regime**

There are a number of key advantages for Hong Kong-based fund managers to incorporate a fund in the form of OFCs. First, the operating costs are lower when compared to establishing and maintaining an offshore fund. The OFC structure can also cater for different types of funds, including private, public, open-ended, closed-ended, listed or unlisted funds.

An OFC may be eligible for profits tax exemption under the Unified Fund Exemption in Hong Kong ("**UFE**") provided that the requirements under the Inland Revenue Ordinance of Hong Kong ("**IRO**") are fulfilled. These requirements include either (a) that insofar as the fund is carrying out "qualifying transactions" they are carried out or arranged in Hong Kong by a "specified person", or (b) that the fund is a "qualified investment fund". This is a complex area which requires specialist tax advice to ensure proper tax planning.

The Grant Scheme for OFCs

To promote the use of the OFC platform for establishing funds as OFCs in Hong Kong, the SFC administers a grant scheme funded by the Hong Kong government to provide subsidies for the formation of qualified OFCs, which will continue until May 2024. The grant scheme covers up to 70% of eligible expenses incurred in relation to the incorporation or re-domiciliation of an OFC and paid to Hong Kong-based service providers, subject to a cap of HK$1 million.