**Hong Kong Bar Association**

**Comments on the Legislative Proposal to introduce an Open-Ended Fund Company Regime in Hong Kong**

1. It is not clear from the Proposal to what extent, if at all, the provisions under the Companies Ordinance (Cap. 622) and the Companies (Winding-up and Miscellaneous Provisions) Ordinance (Cap. 32) are applicable to the OFC. Since the proposed Bill itself covers many aspects governing the incorporation, supervision and management of OFC, it appears that the intention is to exclude most, if not all, of the provisions under Cap. 622 and Cap. 32. The Bill should also make clear that in the event that the provisions under the SFO are in conflict with those in Cap. 622 and Cap. 32, whether it is the provisions under the SFO which take precedence.

2. In any case, it seems to us that the provisions under Cap. 622 and Cap. 32 which are designed to protect the shareholders of a company should be applicable to an OFC. In particular, consideration should be given as to whether in respect of an OFC, the requirement of a shareholder holding the shares for 6 months before he has the *locus* to present a petition for winding-up under s.177(1) of Cap. 32 needs to be revised as there seems to be no justification for requiring a shareholder investing in an OFC to be holding the investment for a long time.

3. §5(f): It is not clear from the Proposal 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 in OFC or (2) an investment in the funds (or sub-funds) managed by the OFC or (3) both. The Bar raises this because under scenario (2), an investor only invests in the funds, and if and for so long as the funds (and the assets held by the funds) are segregated, they cannot be treated as the assets of the OFC and the

investor's investment is protected. In this scenario, an investor withdrawing his investment will not result in any reduction of the capital of the OFC. There is no need to dispense with the provisions governing maintenance of capital under Cap. 622.

4. If, however, what is envisaged under the Proposal is that an investor will be investing in the OFC by subscribing for its issued shares in the OFC (i.e. scenario 1), and the OFC then use the money derived from the subscription to invest in the funds (or sub-funds), then the suggestion to dispense with the provisions governing maintenance of capital is problematic. First, the provisions requiring the maintenance of capital are designed to protect those dealing with the OFC, including creditors and shareholders, so that they can expect the capital to be maintained. Second, under this scenario, it is difficult to see how the money derived from the subscription of shares and applied for investment in the funds (and sub-funds) can be segregated or treated as "trust money" as once the subscription for the shares is paid to the OFC, it becomes the general assets of OFC and cannot be regarded as assets held on trust by the OFC.

5. §5(b) and footnote 2 to it: it is stated that the FSTB is to introduce a 10% *de minimis* limit to allow a maximum 10% of the total gross asset value of the fund to be invested in other asset classes. However, this cannot be found in the Annexes to the Proposal. The Annexes do not provide the complete draft of the Bill, and this limit may have been included in either s.377A or s.377B of the Bill but the draft has not been included in the Proposal.

6. §5(c): the FSTB proposes a requirement that at least one of the directors of the OFC should appoint a process agent in Hong Kong to accept service of process. This cannot been found at ss.377L, 377M, 377N & 377O of the Bill which lay down various requirements for

directors of OFC. The FSTB may decide to include it in the Code of Practice as part of the requirement for applying for registration of an OFC, but the Proposal has not enclosed any draft Code of Practice for comments. In any event, if the purpose of requiring the appointment of a process agent is to ensure that the OFC can be made subject to the jurisdiction of Hong Kong courts, it should be stated as one of the requirements for incorporation or registration of the OFC. If, however, the purpose of the appointment of a process agent is to enable the directors of the OFC can be made subject to the jurisdiction of Hong Kong courts, then the same requirement for appointment of process agent should apply to each of the non-resident director, rather than one of the non-resident directors.

7. Similarly, the FSTB proposes that a custodian to be appointed must at least have a place of business or a process agent in Hong Kong for the purpose of the jurisdiction of Hong Kong courts and accepting service of legal proceedings in Hong Kong. But this requirement has not been found in s.377R of the Bill. The Bar considers that such requirement, which confers jurisdiction of the Hong Kong courts over the custodian, should be included in the Bill, rather than leaving it to the Code of Practice (which appears to be the intention of FSTB).

8. §9: the FSTB proposes a new definition for OFC to be included in the Bill. This cannot be found in the Annexes to the Proposal, and may have been included in ss.377A or 377B of the Bill (the draft of which is not annexed to the Proposal).

C.f. the definition of an "open-ended investment company" in the Financial Services and Markets Act 2000 (UK), s.236:-

**236**
**Open-ended investment companies.**

(1) In this Part "an open-ended investment company" means a collective investment scheme which satisfies both the property condition and the investment condition.

(2) The property condition is that the property belongs beneficially to, and is

managed by or on behalf of, a body corporate ("BC") having as its purpose the investment of its funds with the aim of—

(a) spreading investment risk; and

(b) giving its members the benefit of the results of the management of those funds by or on behalf of that body.

(3) The investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the scheme—

(a) expect that he would be able to realize, within a period appearing to him to be reasonable, his investment in the scheme (represented, at any given time, by the value of shares in, or securities of, BC held by him as a participant in the scheme); and

(b) be satisfied that his investment would be realized on a basis calculated wholly or mainly by reference to the value of property in respect of which the scheme makes arrangements.

(4) In determining whether the investment condition is satisfied, no account is to be taken of any actual or potential redemption or repurchase of shares or securities under—

(a) Chapters 3 to 7 of Part 18 of the Companies Act 2006;

(c) corresponding provisions in force in another EEA State; or

(d) provisions in force in a country or territory other than an EEA state which the Treasury have, by order, designated as corresponding provisions.

(5) The Treasury may by order amend the definition of "an open-ended investment company" for the purposes of this Part.

9. At §27 of the Proposal, the FSTB proposes that an OFC may "end" either by way of termination (streamlined termination process) or by way of a winding-up. In the Annexes to the Proposal, the method of termination has not been specifically enacted as a way to end an OFC. The Bill only gives the power to the SFC to enact rules for the termination of an OFC, or any sub-fund of an OFC: s.377ZC(2)(ze) & (zf). The Bar considers that 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.

*Miscellaneous comments on the draft provisions of the Bill*

10. For s.377O, it tracks the language of s.480 of Cap. 622. At s.377O(3), it is proposed that the Court of First Instance *may* not give leave in the prescribed situation – this is different from s.480(3) where it is provided that the Court *must* not give leave in the same situation. It is suggested that s.377O(3) should use *must* instead of *may* to avoid any inconsistency and confusion.

11. For s.213, the effect of the newly added (3A) and (3B) is that, in relation to a sub-fund of an OFC, the Court may (under (3B)(b)(ii)) order the sub-fund be liquidated and distributed, and (under (3b)(b)(iii)) order the sub-fund to be wound up.

11.1. There appears to be no substantial difference between an order under (3B)(b)(ii) and that under (3B)(b)(iii), if the rules[1] provide that, when the court makes an order under (3b)(b)(ii), liquidators may be appointed for the realization and distribution of the sub-fund's net assets.

11.2. It is suggested that (3B)(b)(iii) be removed, because it implies that the court can make a winding-up order with respect to the sub-fund on the application of the SFC without the need to issue a petition. This appears to be inconsistent with general understanding of insolvency law, and particularly with s.212(1A), where the SFC is required to issue a winding-up petition for a winding-up order against an OFC.

11.3. If (3B)(b)(iii) is to be removed, there should be consequential amendments to s.377ZC(2)(ze) & (zf), and s.377ZCB(b).

11.4. If (3B)(b)(iii) is to be retained, it is suggested that (3A) be further revised to specifically provide that, in relation for an order under (3B)(b)(iii), the Court of First Instance may make such order on the SFC's application if it is desirable in the public interest to do so. This is to track the legal requirement to wind up an OFC under s.212(1A), to make sure that the legal requirement for winding-up a sub-fund is not more restrictive than for winding-up an OFC as a whole.

[1] The rules have not been enclosed in the Proposal for comments.

12. Stylistic comments:-

s.377F(1)(b) – "has effect" should read "has been effected"

s.377L(3) – full stop is missing at the end of the sentence.

**Hong Kong Bar Association**

**11 December 2015**