

HKIFA member firms' feedback/questions on SFC's consultation on the Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies ("OFC")

[Note: For questions raised in the consultation that we do not have any comments or queries, we have omitted them in the reply below.]

1. Proposed Securities and Futures (OFC) Rules and Code on OFC

Under the consultation paper, Para 17 (also Paras 58-61) states that an OFC must appoint an investment manager licensed by the SFC to carry out Type 9 regulated activity. But nothing is mentioned about whether delegation or the appointment of investment advisor is allowed. And if yes, whether there would be any restrictions. We believe that it is important to allow delegation of the investment management function to both local and overseas delegates. Similarly for the appointment of advisors and subadvisors as well. Appreciate that SFC can spell out the stance and requirements.

2. Section II – Key proposals under the OFC Rules and OFC Code

A. Establishment Process and Name of OFC:

Q1. Do you have any comments on the suggested one-stop process for the establishment of an OFC?

- Members generally welcome the 'one-stop' process for the establishment of an OFC. But, can there be greater clarity regarding the approval process, specifically which authority has the final say over the application and the timeline (overall and with the respective authorities), including inter alia for receiving the certificate of incorporation/confirmation of the registration?

Q2. With regards to the suggested factors as to whether a proposed OFC name is "misleading or otherwise undesirable", are there other factors which you think should be taken into account?

- Can SFC comment on how it views the usage of terms such as 'high-alpha', 'strategic' and 'focused' and phrases such as 'social-impact' and 'sustainable and responsible'? Are there any conditions that a fund must meet before it can use these terms? In addition, are there any specific requirements with respect to how the investment manager and/or sub-investment manager should be mentioned/used in the name of the OFC?

B. Legal capacity of an OFC:

Q3. Do you have any views on the proposal regarding the instrument of incorporation and the legal capacity of the OFC?

- Can SFC provide clarity on the following:
 - i) For the purposes of 13.1 of the Code, what should be covered respectively in the instrument of incorporation and the offering documents?
 - ii) What is the role of the Board of Directors vs that of the Custodian with regard to non-material changes?
 - iii) With regard to legal capacity, how will borrowing – generally and on a temporary overdraft basis - be treated for CIS?
 - iv) Can SFC confirm that one Director acting alone is able to execute documentation and therefore bind the OFC?

C. General principles for the OFC and its key operators:

Q4. What are your views on the proposed General Principles in the draft OFC Code as outlined above? Are there any other areas which you think the General Principles should cover?

- The proposed Principles are in order.

D. Key operators:

Q5. Do you have any comments on the proposed requirements as to the eligibility, appointment and removal, and duties of the key operators of an OFC?

- Directors:

An OFC must have a Board with at least two directors. There is the required independence of one director from the Custodian. Does SFC expect this individual to be also independent from the investment manager?

Can the SFC provide more details regarding the approval of directors, including inter alia, qualifications of the candidates, criteria, process, timeline and on-going review process, if required? Can Directors resign at any time, upon which the subsequent appointment of a new director can be made by the remaining Board without shareholder approval/endorsement?

- Investment Manager:

Can we assume that an investment manager can be removed upon the direction of the Board of Directors? What is the procedure and the Notice period required?

Q6. What are your views on the proposed persons and entities which may serve as the process agent of an overseas director and overseas custodian of an OFC?

- What are the obligations and liabilities of those who act in this capacity?

E. Filings with the CR:

Q7. Do you have any views on the proposals concerning the shares, meetings and resolutions of an OFC?

- The proposals are in order.

Q8. Do you agree with the proposed approach with regards to the filings with the CR?

- Can more clarity be provided re the role of the SFC under the two types of filings? The table on P. 17 is not clear. Under Type 1 filings, a number of items are marked with "Yes". Presumably, this means that these items require SFC approval. Correct?

But how about under Type 2 filings, a number of items are also marked with "Yes". However, supposedly, one does not have to go through SFC under this stream. So, what does "Yes" mean under Type 2?

F. Auditors and financial reports:

Q10. Do you agree with the proposed requirements regarding the financial reports of an OFC?

- Can exemption be extended to newly-launched funds that may have been in existence for less than a specified number of months during the first financial period, thus allow the first set of annual financial statements to cover a period longer than 12 months? Can a newly-launched fund be exempted from the requirement to prepare interim report if it has been in existence for less than a specified number of months?

G. Segregated liability of sub-funds and cross sub-fund investments:

Q11. Do you have any comments on the proposed provisions for the segregated liability of sub-funds and cross sub-fund investments?

- The proposed provisions (e.g. disclosure of risks and ring-fencing) are in line with international practice; and are in order.

H. Termination and winding-up:

Q14. Do you agree with the proposed approach to applying the C(WUMP)O's winding-up regime to OFCs and the modifications suggested in the draft OFC Rules when applying the winding-up regime? Are there any modifications which you think should be included?

- C(WUMP)O is well recognised in HK law and fits the OFC legal structure. But, in addition, we would propose to add a condition similar to the closure/merger conditions as required under the Luxembourg law, i.e. would not require shareholder votes to proceed for sub-funds with less than US\$50 million in asset.

I. Requirements applicable to private OFCs:

Q15. Do you have any comments on the wording in the proposed OFC Code in respect of the investment scope of private OFCs?

- Para 108 (a)(b) and Chap 11.1 and 11.2 state that at least 90% in assets constitute type 9 activity, which includes securities and futures contracts. There is a footnote stating "such asset types currently include securities and futures contracts, and will also include OTC derivative products when the relevant provisions of the Securities and Futures (Amendment) Ordinance 2014 come into effect". What is the estimated timeline as to when it will come into effect? Is there a list of all assets constituting Type 9 activities?
- Can a licensed corporation with an expanded Type 9 license with OTC derivatives include OTC derivatives in an OFC's investment portfolio?

Q17. Do you have any views on the proposed approach to the different types of scheme changes of a private OFC?

- Para 113 states that material changes to a private OFC would require the approval of the SFC. This does not apply to unauthorized unit trust. Will there be different treatment for a private OFC vs. an unauthorized unit trust? If yes, what would be the differences?

3. Others

- Within a public OFC umbrella, can there be private OFC sub-funds as long as they observe the rules applicable to private OFCs?
- Can an existing HK Trust convert to an OFC which is not covered in the consultation paper? If yes, can SFC allow such a conversion? If yes, what would be the procedures and are there any additional requirements, if any?

(End)