

By e-mail: ofc-consultation@sfc.hk

Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

29 August 2017

Dear Sirs

Consultation Paper on the Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies ("Consultation Paper")

We welcome the opportunity to comment on the Consultation Paper on the Securities and Futures (Open-ended Fund Companies) Rules ("OFC Rules") and Code on Open-ended Fund Companies ("OFC Code") issued by the Securities and Futures Commission ("SFC") on 28 June 2017.

We strongly support the Government's initiative to enhance Hong Kong's reputation as an international asset management centre through the introduction of open-ended companies ("OFC"), which gives fund managers an additional choice of fund vehicle domiciled in Hong Kong. The success of OFC will depend on, amongst others, whether the OFC Rules, OFC Code and other OFC related laws, rules and regulations are sufficiently flexible, cost-effective and tax-efficient for the fund managers and the investors. We support a framework where the administration and operation of an OFC (which includes its establishment, maintenance, termination and winding up) are streamlined as it creates a level playing field with other investment fund centres.

Tax treatment is one of the key factors which will drive fund managers' decision in determining the place of domicile of the fund and the investment manager. In this regard, we fully support and welcome the recent gazettal of the Inland Revenue (Amendment) (No. 4) Bill 2017 which extends the exemption from Hong Kong profits tax to privately offered OFCs.

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We have provided our comments to the questions in the Consultation Paper, gathering also the views from various clients in the asset management industry.

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

We support the SFC's proposal as it allows an OFC applicant to deal only with the SFC on the entire registration process, which is efficient and user friendly. It will be helpful if the SFC would indicate the timing it will normally take for it to process an OFC's registration application after such applicant submits all the required documents.

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? Please explain your view.

We support the SFC's proposal.

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

Overall, we support the SFC's proposal. However, if the instrument of incorporation will be altered, it is proposed that the OFC may do so if, amongst others, the custodian has certified the immateriality of the change or the necessity to comply with applicable statutory or regulatory requirements. Whilst this is similar to the amendment to be made to Section 6.7 of the Code on Unit Trusts and Mutual Funds in the SFC Products Handbook, we consider that for privately offered funds, it should be the board of directors - as opposed to a service provider such as the custodian - should make such determination.

We note the OFC Code proposes that the draft OFC Rules will provide that "any transaction entered into by the OFC which falls outside its operation as a collective investment scheme will be invalid. This ensures the OFC will only operate as an investment fund" (our emphasis added).

It will be very difficult if not impossible to determine for a third party whether a transaction falls within the OFC's operation as a collective investment scheme, and the potential unenforceability of contracts is more likely to be to the detriment of a third party than the OFC that willingly engages into an act outside its scope. Moreover, for good reason, the Companies Ordinance has done away with ultra vires ten years ago and companies have the same power as a natural person. For the sake of the protection of counterparties and investors, we see no reason why the doctrine should be reintroduced for OFCs. We therefore strongly oppose to proposed ultra vires rule.

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?

We agree with the proposed General Principles.

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? Please explain your view.

Investment manager

We agree that an OFC must have at least one investment manager who is licensed by or registered with the SFC to carry out the regulated activity of asset management.

It is not clear - from section 124(3) of the OFC Rules - whether the appointment of one of more sub-managers requires the SFC's prior approval. It should not be necessary for privately offered OFC to seek the SFC's prior approval for the appointment of sub-managers, on the basis that the managers licensed by or registered with the SFC remain ultimately responsible for the management of the funds.

Custodian

We assume that a custodian under the "direct model" (i.e. where the board or the investment manager appoints multiple custodians directly (and therefore creates multiple contractual agreements) in a single agreement) or a global custodian under the "global custody model" (i.e. where the board or the investment manager appoints one custodian, who will in turn appoint multiple custodians and the investment manager will not have contractual relationships with the sub-custodians) do not require approval.

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?

We support the SFC's proposal. It would be helpful for the SFC to confirm in the OFC Code that sub-custodians are not obliged to comply with the above as, amongst others, it is clearly not practicable for the sub-custodians to do so.

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

In our view, the provisions under the OFC Rules applicable to meetings are very prescriptive. We note that it is unnatural for private funds to hold shareholders' meetings. We consider more flexibility should be granted to the OFC's constitutive documents, as agreed by the shareholders which subscribe for interests in the OFC from time to time. This will give fund managers, especially managers of privately managed funds, to include meeting related provisions in the constitutive documents which are in line with prevailing market practice.

Q8. Do you agree with the proposed approach with regards to the filings with the CR? Please explain your view.

The determination of the competent authority for these filing requirements appears to be complex and will likely lead to errors. We would suggest that all filings should be made to the SFC to eliminate the potential for confusion.

Q9. Do you have any views on the proposed eligibility, appointment and removal, and rights and powers of the auditors in the draft OFC Rules?

We do not have any comments on the above.

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

We do not have any comments on the above.

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

We oppose the proposed mandatory disclosure in relation to enforcement in foreign courts. First, if the Hong Kong authorities mandate such disclosure, it indicates that Hong Kong authorities do not believe that the concept of segregated liability will hold up in foreign courts, although segregated portfolio companies have been established in many jurisdictions and have been judicially sanctioned. Second, the mandatory disclosure creates an invitation for creditors to try to enforce claims in such foreign courts. It should be every OFC's own decision as to the risk factors it considers appropriate.

Q12. Do you have any comments on the proposed draft OFC Rules regarding arrangements and compromises? Please explain your view.

We do not have any comments on the above.

Q13. What are your views on the proposed requirements and steps for termination by application to the SFC?

It will be helpful if the proposal which the fund manager needs to submit to the SFC under Chapter 10.3 of the OFC Code will also include the ways the managers propose to retrieve the assets of the OFC from the custodian(s) and an estimated timeframe for doing so.

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 other modifications which you think should be included? Please explain your view.

We do not have any comments on the above.

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

As was pointed out by many respondents in previous consultations, we deplore the limitation of the investment scope to instruments that fall under Type 9 regulated activity, as it unduly restricts the appeal and usability of OFCs. We also consider that the hard limit of 90%/10% and potential sanction of a breach are problematic, as this looks at current valuation as opposed to valuation when an investment was made. This means that a manager will need to create a reserve above which it cannot make non-SFO type investments, so in reality the de minimis threshold will more likely be around 5% for a prudent manager, which is too small to be meaningful.

Q16. Do you agree with the proposed approach and basic requirements concerning fund operations and disclosure by a private OFC? Do you think that there are other requirements that should be included in the proposed OFC Code? Please explain your view.

We agree with the SFC's proposal.

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

We do not have comments on the above.

Others

Rule 61 of the OFC Rules

In our view, the requirements to either register the transfer or send the transferee and the transferor notice of refusal to register the transfer within 2 months is too short.

Rule 159 of the OFC Rules

Under Cayman Islands law, a portfolio cannot invest in another portfolio. It would be interesting to find out the reasons for the SFC's proposal.

Should the SFC wish to discuss any of our comments please do not hesitate to contact
, - and

Yours faithfully

Clifford Chance