



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

Consultation Paper on Proposed Enhancements to the Open-ended Fund Companies Regime

December 2019

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Foreword

The Securities and Futures Commission (SFC) invites market participants and interested parties to submit written comments on the proposals discussed in this consultation paper or to comment on related matters that might have a significant impact upon the proposals by no later than 20 February 2020. Any person wishing to comment on the proposals on behalf of an organisation should provide details of the organisation whose views they represent.

Please note that the names of the commentators and the contents of their submissions may be published on the SFC's website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation paper.

You may not wish the SFC to publish your name, submission or both. If this is the case, please state that you wish your name, submission or both to be withheld from publication when you make your submission.

Written comments may be sent as follows:

By mail to: The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Re: Consultation Paper on Proposed Enhancements to the
Open-ended Fund Companies Regime

By fax to: (852) 2877-0318

By online submission at: <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/>

By e-mail to: ofc-2019consultation@sfc.hk

All submissions received before the end of the consultation period will be taken into account before the proposals are finalised and a consultation conclusions paper will be published in due course.

Securities and Futures Commission
Hong Kong

20 December 2019

Personal Information Collection Statement

1. This Personal Information Collection Statement (PICS) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes; or
 - (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere as part of this public consultation. The names of persons who submit comments on this consultation paper, together with the whole or any part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance (Cap. 486).

² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

The Data Privacy Officer
The Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

7. A copy of the Privacy Policy Statement adopted by the SFC is available upon request.

Proposed enhancements to the open-ended fund companies regime

Executive summary

Background

1. The introduction of the open-ended fund companies (OFC) structure in Hong Kong is part of the SFC's initiatives to enhance market infrastructure to further develop Hong Kong as a full-service international asset management centre and a preferred fund domicile. Following completion of the public consultations and legislative process³, the OFC regime came into effect on 30 July 2018.
2. Since the implementation of the OFC regime last year, we have maintained close dialogue with industry stakeholders and received many enquiries regarding applications for the registration of public and private OFCs. We noted from the feedback received that there may be practical issues faced by the industry in adopting the OFC structure, particularly in respect of private OFCs.
3. In light of these issues and the latest market and international regulatory developments discussed below, we have reviewed the current OFC regime and identified a few areas in which some fine-tuning could be made to facilitate the adoption of this new structure by the industry.

Proposed enhancements to the OFC regime

4. As noted in the consultation conclusions paper issued by the SFC⁴, a phased approach would be adopted to implement the winding-up regime for OFCs. We are currently working on the legislative amendments (phase two) to enable the winding-up of OFCs to be effected in the same manner as conventional companies. We would like to take the opportunity of this phase two legislative exercise to effect the proposed enhancements to the OFC regime.
5. We are proposing enhancements in the following areas:
 - (a) custodian eligibility requirements for private OFCs;
 - (b) expansion of investment scope for private OFCs;
 - (c) re-domiciliation of overseas corporate funds; and
 - (d) significant controllers register requirements.

³ The [Open-ended Fund Companies Consultation Paper](#) issued by the Financial Services and the Treasury Bureau (FSTB); the [Open-ended Fund Companies Consultation Conclusions](#) issued by the FSTB; the [Consultation Paper on the Securities and Futures \(Open-ended Fund Companies\) Rules and Code on Open-ended Fund Companies](#) issued by the SFC; and the [Consultation Conclusions on Securities and Futures \(Open-ended Fund Companies\) Rules and Code on Open-ended Fund Companies](#) issued by the SFC.

⁴ The [Consultation Conclusions on Securities and Futures \(Open-ended Fund Companies\) Rules and Code on Open-ended Fund Companies](#) issued by the SFC in May 2018.

6. The proposed enhancements mentioned in paragraph 5(a) and (b) will be effected by way of amendments to the Code on Open-ended Fund Companies (OFC Code). In relation to custodian eligibility requirements, we propose to allow intermediaries licensed or registered for the regulated activity of dealing in securities (RA1) to act as custodians of private OFCs provided that the intermediary meets certain requirements as set out in this paper. We also propose to expand the current investment scope for private OFCs to include loans as well as Hong Kong private company shares and debentures. The proposed amendments to the OFC Code are set out in Appendix I to this paper.
7. As the proposed amendments to the OFC Code do not require any legislative changes, we propose to first proceed with these amendments and have them take immediate effect.
8. The proposed enhancements in paragraph 5(c) and (d) will require legislative amendments. We propose to introduce provisions in the SFO and make ancillary amendments to the Securities and Futures (Open-ended Fund Companies) Rules (OFC Rules) to facilitate the re-domiciliation of overseas corporate funds to Hong Kong using the OFC structure. We also propose to introduce requirements under the OFC Rules to require OFCs to keep a register of beneficial shareholders similar to the requirements under the Companies Ordinance (Cap. 622) (CO).
9. Subject to consultation feedback, an amendment bill will be introduced into the Legislative Council to proceed with the legislative process. We will engage with the relevant stakeholders throughout the process.
10. We propose that the re-domiciliation mechanism will take effect immediately following completion of the legislative process. We propose a six-month transition period in respect of the significant controllers register requirements to allow the industry reasonable time to prepare for implementation.

Inviting comments

11. The SFC invites comments on the proposed enhancements to the OFC regime discussed in this consultation paper by no later than 20 February 2020. A consultation conclusions paper will be published as soon as practicable after the end of the consultation period.

Proposed enhancements to the OFC regime

A. Custodian eligibility requirements for private OFCs

12. Under the current OFC Code⁵, the custodian of an OFC should meet the same eligibility requirements for custodians of SFC-authorized funds as set out in the Code on Unit Trusts and Mutual Funds (UT Code). These eligibility requirements essentially mean that a custodian must be a Hong Kong or overseas bank or a trustee of a registered scheme under the Mandatory Provident Fund Schemes Ordinance. This applies irrespective of whether the OFC is a private OFC or a public OFC.
13. Since the implementation of the OFC regime in July 2018, we have maintained close dialogue with various stakeholders including investment managers with an interest in establishing private funds adopting an OFC structure. We have received feedback that there are practical difficulties in engaging custodians for private OFCs which meet the UT Code eligibility requirements. As SFC-authorized public funds tend to be larger, these custodians' fee structures may not be economical for private funds which may be smaller in scale and size, at least upon inception. Some of these custodians may also have minimum fund size requirements. It was also noted that it is common for private funds' assets to be held by prime brokers.
14. In light of the feedback received, we have reviewed the eligibility requirements for custodians of private OFCs, taking into account the eligibility requirements for custodians of private funds adopted in other major fund jurisdictions as well as the latest overseas developments. For example, registered broker-dealers in the US and authorized investment firms providing broker-dealer-type investment services in Europe can generally act as custodians for private funds⁶.
15. To ensure the OFC structure can be practically and broadly adopted by private funds, which in turn would enhance Hong Kong's competitiveness as a preferred fund domicile, we propose to also allow an intermediary, which is licensed or registered to carry on Type 1 regulated activity (ie. RA1 - dealing in securities), to act as a custodian of private OFCs, provided that the intermediary meets the following requirements:
 - (a) the intermediary's licence or registration granted under section 116(1) or section 119(1) of the SFO (as the case may be) is not subject to the condition that it shall not hold client assets. The terms "hold" and "client assets" are as defined in the SFO;
 - (b) where the intermediary is a licensed corporation, the licensed corporation meets the capital requirements of minimum paid-up share capital of HK\$10 million and minimum liquid capital of HK\$3 million – this is in line with the proposed capital requirement for

⁵ 7.1 of the OFC Code

⁶ Under the proposed variable capital company regime in Singapore, broker-dealers are also eligible to act as custodians for private variable capital companies if they hold a capital markets services licence for providing custodial services.

custodians of SFC-authorized funds which are licensed corporations under our proposals to regulate the trustees/custodians of SFC-authorized funds⁷ (RA13 regime);

- (c) the private OFC is a client of the intermediary in respect of its RA1 business at all times; and
- (d) the intermediary must be independent of the investment manager.

16. Further, in order to ensure that the SFC has a sufficient regulatory nexus over the intermediary's custodian business, we would impose a condition on the intermediary's licence or registration (as the case may be) to the effect that it must comply with all requirements applicable to it as a custodian of an OFC, including the requirements in the OFC Code and related guidance issued by the SFC from time to time.
17. We would also like to take this opportunity to provide more guidance to custodians of private OFCs in relation to the safe-keeping of OFC assets. Hence, we propose more detailed requirements in a new Appendix A to the OFC Code to further elaborate on the obligations of an OFC custodian in Chapter 7 of the OFC Code. These have been adopted from similar existing requirements such as those for dealings in client money and client securities and the keeping of records⁸, as well as those regarding internal policies and procedures, systems and controls. Accordingly, these detailed requirements are not expected to create an additional compliance burden for private OFC custodians, but rather should assist them in providing custodial services.
18. If and when the RA13 regime comes into effect, an RA13 intermediary (ie depositary) which also acts as a custodian of a private OFC will have to comply with the requirements set out in the OFC Code, including those set out in the new Appendix A. Furthermore, a condition will be imposed on its licence or registration (as the case may be) consistent with the approach mentioned in paragraph 16.
19. Details of the proposed amendments to the OFC Code are set out in Appendix I to this paper.

Question:

1. Do you agree with the proposal to allow intermediaries licensed or registered for RA1 to act as custodians for private OFCs? Please explain your views.
2. Do you have any comments on the proposed eligibility criteria applicable to RA1 intermediaries which intend to be private OFC custodians? Do you have any other suggestions?
3. Do you have any comments on the proposed requirements in the new Appendix A to the OFC Code to be imposed on all private OFC custodians, including existing

⁷ [Consultation Paper on the Proposed Regulatory Regime for Depositaries of SFC-authorized Collective Investment Schemes](#) issued by the SFC in September 2019.

⁸ The Securities and Futures (Client Money) Rules, Securities and Futures (Client Securities) Rules, Securities and Futures (Keeping of Records) Rules.

private OFC custodians, RA1 intermediaries which intend to be private OFC custodians and RA13 intermediaries which also act as custodians of private OFCs when the RA13 regime comes into effect?

4. Do you have any comments on the other proposed amendments to Chapter 7 of the OFC Code?

B. Expansion of investment scope for private OFCs

20. Currently, under the OFC Code⁹, a private OFC must invest at least 90% of its gross asset value (GAV) in securities and futures contracts¹⁰ and/ or cash, bank deposits, certificates of deposit, foreign currencies and foreign exchange contracts. A private OFC may also invest in other asset classes, but only up to 10% of its GAV (the 10% de minimis investment limit).
21. Following the launch of the OFC regime, we received substantial feedback that a private OFC should be allowed to invest in loans and in shares and debentures of Hong Kong private companies¹¹ given they are common asset classes in which private funds invest. Investments in these two asset classes are currently subject to the 10% de minimis investment limit.
22. Under Hong Kong's unified profits tax regime for funds which took effect in April 2019, both onshore and offshore funds can enjoy profits tax exemption subject to meeting certain conditions¹². In view of this new tax incentive and the latest economic substance requirements¹³ in offshore fund jurisdictions¹⁴, the industry anticipated that more private funds would consider moving "onshore" to where their substantial activities are conducted and Hong Kong would be a logical choice for many fund managers. Expanding the investment scope of private OFCs to these two common asset classes can help enhance Hong Kong's competitiveness as a preferred fund domicile. It was also pointed out that allowing asset managers using an OFC structure to invest in Hong Kong private companies' shares and debentures can also facilitate the development of local companies to the benefit of Hong Kong's economy.
23. Loans are a conventional and well-established financial asset class similar in terms of economic substance to debt securities. Apart from technically not falling within the "securities" definition under the SFO, Hong Kong private companies' shares and debentures

⁹ 11.1 and 11.2 of the OFC Code.

¹⁰ As the terms are defined in the SFO. A private OFC will also be able to invest in OTC derivatives when the relevant provisions of the Securities and Futures (Amendment) Ordinance 2014 come into effect.

¹¹ Shares and debentures of Hong Kong private companies do not fall within the definition of "securities" in the SFO.

¹² Insofar as an OFC is concerned, an OFC is exempted from payment of tax on its profits derived from transactions in assets of both Schedule 16C of the Inland Revenue Ordinance (IRO) class and non-Schedule 16C of the IRO class other than in certain situations (ie, "no direct trading or direct business undertaking" and "no utilization of non-Schedule 16C assets with a view to generating income"). See the provisions in sections 20AN and 20AS of the IRO for details.

¹³ These requirements have been introduced to meet the obligations under the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting initiatives.

¹⁴ Such as the Cayman Islands and the British Virgin Islands

are in essence no different in nature from shares and debentures of overseas private companies in which an OFC may currently invest freely without any limit under the OFC Code.

24. Accordingly, we propose to allow an expansion of the investment scope of private OFCs to include (a) loans and (b) shares and debentures of Hong Kong private companies, provided that the private OFC's assets must include a portfolio of those asset types the management of which would constitute a Type 9 (asset management) regulated activity (RA9). This would ensure the SFC has a sufficient regulatory nexus under the SFO in terms of its supervisory, investigatory, disciplinary and enforcement powers over the management and safekeeping of OFC assets.
25. The primary purpose of a private OFC should be to operate as an investment fund and it must not be a business undertaking for general commercial or industrial purpose¹⁵. Accordingly, despite this expansion of investment scope, a private OFC must not engage in a money lending business.
26. Under the new unified profits tax regime for funds, a private OFC may enjoy profits tax exemption subject to meeting certain conditions¹⁶. Profits tax liability would arise if a private OFC falls within any of the situations under which the profits tax exemption does not apply¹⁷.
27. Details of the proposed amendments to the OFC Code to effect this proposal are set out in Appendix I to this paper.

Question:

5. Do you have any comments on the proposed expansion of the investment scope of private OFCs to loans and shares and debentures of Hong Kong private companies? Please explain your views.

C. Re-domiciliation of overseas corporate funds

28. Under the current OFC regime, corporate funds from overseas jurisdictions may re-domicile to Hong Kong by various means, for example an asset transfer or share swap. While these are not uncommon ways for a fund to move between jurisdictions, we have received a number of comments from the industry suggesting that a statutory re-domiciliation regime should be introduced in Hong Kong. In view of the latest regulatory developments in the traditional offshore fund jurisdictions, the industry anticipated that existing offshore funds might move to “onshore” jurisdictions such as Hong Kong¹⁸. This highlights the importance of a statutory re-domiciliation regime.

¹⁵ 11.4 of the OFC Code

¹⁶ See footnote 12 above. Public OFCs can enjoy the long established profits tax exemption available to SFC-authorized funds.

¹⁷ For example, under the situations set out in section 20AS of the IRO

¹⁸ Please refer to the discussion in paragraph 22 above.

29. Having considered these comments and the latest international regulatory developments¹⁹, we propose to enhance the OFC regime by introducing a statutory mechanism to facilitate the re-domiciliation of overseas corporate funds to Hong Kong using the OFC structure.
30. Under the proposed statutory mechanism, an existing fund's corporate identity, continuity and track record would be preserved. Not having to establish a completely new legal entity could save costs for the fund, such as those incurred for re-entering into contracts with key operators and financing arrangements with banks, and re-acquiring investments.
31. Further, since there will be no change in the legal personality of the corporate fund, there will be no "transfer" of assets from one legal person to another when the fund migrates to Hong Kong using the OFC structure. This may result in stamp duty savings.
32. The proposal would be effected by introducing new provisions in Part IVA of the SFO and making ancillary amendments to the OFC Rules.
33. The key features of the proposed statutory re-domiciliation mechanism for OFCs are set out in Appendix II to this paper. These requirements are generally on par with other overseas re-domiciliation mechanisms.
34. After an overseas corporate fund has re-domiciled in Hong Kong, it will become an OFC and must observe all the legal and regulatory requirements for OFCs. Accordingly, the SFC's regulatory and enforcement powers in respect of OFCs will be fully applicable to it.

Question:

6. Do you have any comments on the proposed re-domiciliation mechanism to facilitate the migration of overseas corporate funds to Hong Kong or the mechanism's specific features and requirements? Please explain your views.

D. Significant controllers register requirements

35. As a member of the Financial Action Task Force (FATF) and in recognition of the importance of anti-money laundering and counter-terrorist financing (AML/CFT) to Hong Kong's status as a major international financial centre, the SFC regularly reviews the AML/CFT measures which are under its purview. Currently, there are AML/CFT obligations imposed on the investment managers of OFCs and SFC-licensed or registered intermediaries involved in the sale of OFC shares.
36. To enhance the transparency of corporate beneficial ownership in respect of OFCs, we propose to impose requirements on OFCs for the keeping of a register of beneficial shareholders under the OFC Rules, which will be similar to the significant controllers register (SCR) requirements under the CO.

¹⁹ Apart from the latest regulatory developments in the traditional offshore fund jurisdictions discussed above, a re-domiciliation mechanism is also being provided under the proposed variable capital company regime in Singapore.

37. Under the CO, a company incorporated in Hong Kong is required to obtain and maintain up-to-date beneficial ownership information by way of keeping an SCR for inspection by law enforcement officers upon demand and to inform the Companies Registry of the place where the SCR is kept.
38. We propose to adopt essentially the same definition of beneficial owner as that under the CO, such that a person will be considered to have significant control over an OFC if one or more of the following conditions are met:
- (a) the person holds, directly or indirectly, more than 25% of the issued shares in the OFC or, if the OFC does not have a share capital, the person holds, directly or indirectly, a right to share in more than 25% of the capital or profits of the OFC;
 - (b) the person holds, directly or indirectly, more than 25% of the voting rights of the OFC;
 - (c) the person holds, directly or indirectly, the right to appoint or remove a majority of the board of directors of the OFC;
 - (d) the person has the right to exercise, or actually exercises, significant influence or control over the OFC; or
 - (e) the person has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or a firm that is not a legal person, but whose trustees or members satisfy any of the first four conditions (in their capacity as such) in relation to the OFC.
39. These requirements could further enhance the AML/CFT measures in respect of OFCs in line with the FATF principles.

Question:

7. What are your views on the proposed adoption of the significant controllers register requirements under the CO in the OFC regime?

Other amendments

40. As noted in the consultation conclusions paper issued by the SFC²⁰, a phased approach would be adopted to implement the winding-up regime for OFCs. We are currently working on the relevant legislative amendments to enable the winding-up of OFCs to be effected in the same manner as conventional companies.

²⁰ The [Consultation Conclusions on Securities and Futures \(Open-ended Fund Companies\) Rules and Code on Open-ended Fund Companies](#) issued by the SFC in May 2018.

Implementation timeline

41. The proposals set out in this paper will be subject to a two-month public consultation. Taking into account the respondents' comments, a consultation conclusions paper will be issued together with the proposed changes to the OFC Code revised as appropriate, which we propose will take immediate effect upon gazettal.
42. The drafting of the legislative amendments for implementing the re-domiciliation mechanism, SCR requirements and winding-up regime for OFCs is ongoing. Subject to consultation feedback, the relevant amendment bill will be introduced into the Legislative Council. We will engage with the relevant stakeholders throughout the process.
43. We propose that the re-domiciliation mechanism will take effect immediately following completion of the legislative process. There will be a six-month transition period for the SCR requirements to allow the industry reasonable time to prepare for implementation.

Question:

8. Do you have any comments on the proposed implementation timelines?
9. Would there be any difficulty for existing private OFC custodians to comply with the proposed requirements in the new Appendix A to the OFC Code if they were to take immediate effect? Please explain your views.

Seeking comments

44. The SFC welcomes any comments from the public and the industry on the proposals made in this consultation paper and on the proposed amendments to the OFC Code as set out in Appendix I. Please submit comments to the SFC in writing no later than 20 February 2020.

Proposed amendments to the OFC Code

Chapter 6: Investment manager

- 6.1 An investment manager of an OFC must be and remain fit and proper at and after the time of registration of the OFC.

Note: The Commission may take into account relevant guidance issued by the Commission relating to the fitness and properness of licensed and/ or registered intermediaries when considering the acceptability of the investment manager for the purpose of the registration of an OFC.

- 6.2 The investment manager must carry out the investment management functions of the OFC in accordance with the OFC's instrument of incorporation and investment management agreement, in the best interests of the OFC and its shareholders.

- 6.2A In conducting the investment management functions of the OFC, the investment manager should comply with the Fund Manager Code of Conduct, the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Authorized Institutions).

- 6.3 The circumstances under which the appointment of the investment manager must cease to hold office and the procedures of removal from office should be included in the investment management agreement and disclosed in the offering documents of the OFC.

- 6.4 The OFC should put in place appropriate arrangements as far as reasonably practicable for the purpose of complying with the applicable regulatory requirements for the OFC to have at least one investment manager licensed or registered for Type 9 regulated activity.

Note: For example, there should be a termination notice requirement of sufficient length of time to enable the OFC to effect a replacement to meet the applicable regulatory requirements. The OFC should also establish appropriate procedures to prepare for and facilitate a replacement in the event of any retirement or removal of the investment manager. Early consultation with the Commission is encouraged in the case of a change or intended change of investment manager.

- 6.5 The investment manager must retire:
- (a) when it ceases to meet the eligibility requirements under the applicable regulatory requirements; or

- (b) in such other cases as provided for in the OFC's instrument of incorporation and/or the investment management agreement with the OFC.

Chapter 7: Custodian and custody of assets

7.1 The custodian of an OFC should:

(a) for public OFCs, meet the same eligibility requirements as set out in the UT Code for SFC-authorized funds; and

(b) for private OFCs:

(i) meet the same eligibility requirements as set out in the UT Code for SFC-authorized funds; or

(ii) be a licensed corporation or registered institution licensed or registered for Type 1 regulated activity and meet the following criteria:

A. its licence or registration granted under section 116(1) or section 119(1) of the SFO (as the case may be) is not subject to the condition that it shall not hold client assets;

Note: The terms "hold" and "client assets" are as defined in the SFO.

B. for a custodian which is a licensed corporation, it at all times maintains paid-up share capital of not less than HK\$10 million and liquid capital of not less than HK\$3 million;

C. the private OFC is, and remains at all times, a client of such licensed corporation or registered institution in respect of its business in Type 1 regulated activity; and

D. be independent of the investment manager.

Note: While the custodian and the investment manager may be bodies corporate having the same ultimate holding company, the custodian must be functionally independent of the investment manager. Amongst other things, there should be systems and controls in place to ensure that persons fulfilling the custodial function / safekeeping of the OFC's scheme property are functionally independent of persons fulfilling the OFC's investment management functions.

7.2 Where the custodian is an overseas entity and is not a registered non-Hong Kong company, it must have a process agent at all times in Hong Kong for the purpose of accepting the service of notices and documents in Hong Kong.

Notes: (1) In accordance with the OFC Rules, the following persons/ entities may act as a process agent: (a) an individual whose usual residential address is in Hong Kong, (b) a company formed and registered under the CO in Hong Kong, or (c) a firm of solicitors or certified public accountants in Hong Kong.

(2) If the custodian is a registered non-Hong Kong company, service of process should be made to the authorized representative of the company as is required to be appointed under the CO.

7.3 The custodian must:

- (a) (i) hold in its custody all ~~assets-scheme property~~ which can be so held, whether by the delivery of physical assets and/ or documents of title, or by way of registration in book entry form in the account of the OFC in the custodian's books;
- (ii) maintain a proper record of all other ~~assets-scheme property~~ of the OFC which by ~~their~~ its nature cannot be held in custody in the account of the OFC in the custodian's books;

- (b) maintain proper and up-to-date records of all ~~assets-scheme property~~ belonging to the OFC, including cash and scheme property that cannot be held in custody, in the custodian's books, which should include frequent reconciliations;

Note: It is generally expected that there should be reconciliations with the statement of accounts provided by other financial institutions on a regular basis where appropriate.

- (c) put in place appropriate measures for the verification of ownership of ~~assets-scheme property~~ of the OFC;
- (d) segregate the scheme property of the OFC from the assets of the custodian and, unless the scheme property of the OFC is held in an omnibus client account with adequate safeguards in line with international standards and best practices to ensure that the scheme property of the OFC is properly recorded with frequent reconciliations, segregate the ~~assets-scheme property~~ of the OFC from:
 - (i) the assets of the investment manager of the OFC and its affiliates;
 - (ii) the assets of ~~the custodian/ a sub-custodian~~, if any, throughout the custody chain; and
 - (iii) the assets of other clients of the custodian throughout the custody chain and the assets of the investment manager's affiliates, unless held in an omnibus client account with adequate safeguards to ensure that assets

~~of the OFC are properly recorded;~~

- (e) not reuse the ~~assets~~ scheme property of the OFC without prior consent from the OFC; ~~and~~
- (f) put in place adequate risk management measures to ensure that it can properly carry out the above functions; and
- (g) for private OFC custodians, comply with the more detailed requirements for safekeeping of OFC scheme property set out in Appendix A.

- 7.4 The custody arrangements in respect of the scheme property of the OFC and any material risks associated with the arrangements should be disclosed in its offering document.
- 7.5 The circumstances under which the custodian must cease to hold office and the procedures of removal from office should be included in the custody agreement and disclosed in the offering documents of the OFC.
- 7.6 The OFC should put in place appropriate arrangements as far as reasonably practicable for the purpose of complying with the applicable regulatory requirements for the OFC to have at least one custodian.

Note: For example, there should be a termination notice requirement of sufficient length of time to enable the OFC to effect a replacement to meet the applicable regulatory requirements. The OFC should also establish appropriate procedures to prepare for and facilitate a replacement in the event of any retirement or removal of the custodian. Early consultation with the Commission is encouraged in the case of a change or intended change of custodian.

Section II: Requirements applicable to private OFCs only

Chapter 11: Investment scope

- 11.1 Subject to 11.1A, At least 90% of the gross asset value of a private OFC must consist of (1) those asset types the management of which would constitute a Type 9 regulated activity, shares or debentures of a private company, loans, and/ or (2) cash, bank deposits, certificates of deposit, foreign currencies and/ or foreign exchange contracts.

Note: "Private company" refers to a private company within the meaning of section 11 of the Companies Ordinance (Cap. 622).

- 11.1A The assets of a private OFC must include a portfolio of those asset types the management of which would constitute a Type 9 regulated activity.

- 11.2 A private OFC may invest in other asset classes not set out in 11.1 of a value not exceeding a maximum of 10% of the gross asset value of the OFC ("10% de minimis limit"), such 10% de minimis limit shall be set out in the instrument of incorporation of the OFC.
- 11.3 In the case of an umbrella OFC, the 10% de minimis limit is applicable to the gross asset value of each sub-fund as well as to the gross asset value of the umbrella OFC as a whole.

Note: The investment manager is expected to manage and monitor its investments on an on-going basis and in a prudent manner to ensure compliance with the 10% de minimis limit.

- 11.4 A private OFC must not be a business undertaking for general commercial or industrial purpose.

Note: A private OFC will generally be regarded as "a business undertaking for general commercial or industrial purpose" if it engages predominantly in:

- (i) a commercial activity, involving the purchase, sale and/or exchange of goods or commodities, and/or supply of services; and/ or*
 - (ii) an industrial activity, involving the production of goods or construction of properties.*
- 11.5 The investment scope and investment strategies adopted by the investment manager, including the restriction of the 10% de minimis limit, must be clearly disclosed in the offering documents of the OFC.

Requirements for safekeeping of private OFC scheme property under 7.3(g) of the OFC Code

1. Custodians of private OFCs (“Private OFC Custodian”) should comply with the requirements set out in this Appendix.

Money of the private OFC in Hong Kong

2. Where a Private OFC Custodian that is not a bank receives or holds any money on behalf of a private OFC in Hong Kong (“Hong Kong Scheme Money”), it should:

(a) establish and maintain in Hong Kong one or more segregated bank accounts designated as a trust account or client account for holding the Hong Kong Scheme Money received by it. Such bank account(s) should be established and maintained with an authorized financial institution in Hong Kong;

(b) pay all amounts of Hong Kong Scheme Money into a segregated bank account mentioned in paragraph 2(a) of this Appendix within one business day after the receipt of such monies;

(c) ensure that any amount of Hong Kong Scheme Money is retained in a segregated bank account mentioned in paragraph 2(a) of this Appendix until it is:

(i) paid in accordance with a written direction for Hong Kong Scheme Money from or on behalf of the private OFC;

Note: A “written direction for Hong Kong Scheme Money” is a written notice given to a Private OFC Custodian by or on behalf of a private OFC directing the Private OFC Custodian to pay a specified amount of Hong Kong Scheme Money in a particular manner and ceases to have effect after the Hong Kong Scheme Money to which it relates has been paid by the Private OFC Custodian in the manner directed.

(ii) paid in accordance with a standing authority for Hong Kong Scheme Money from or on behalf of the private OFC;

Note: A “standing authority for Hong Kong Scheme Money” is a written notice given to a Private OFC Custodian by or on behalf of a private OFC authorizing the Private OFC Custodian to deal with Hong Kong Scheme Money from time to time in one or more specified ways before the expiry date of the authority.

- (iii) required in order to meet the private OFC's obligations to meet settlement or margin requirements in respect of any investment transaction carried out by the investment manager of the private OFC on behalf of the private OFC; or
 - (iv) required to pay Hong Kong Scheme Money that the private OFC, on whose behalf such Hong Kong Scheme Money is held by the Private OFC Custodian, owes to the Private OFC Custodian in respect of:
 - A. the carrying on by the Private OFC Custodian of any regulated activity for which it is licensed; or
 - B. acting as the custodian of the private OFC;
 - (d) not pay any amount of Hong Kong Scheme Money pursuant to a standing authority for Hong Kong Scheme Money if:
 - (i) to do so would be unconscionable; or
 - (ii) the standing authority authorizes payment to an account in Hong Kong of
 - A. the Private OFC Custodian or its associated entity in circumstances other than those set out in paragraph 2(c)(iii) or (iv) of this Appendix; or
 - B. any corporation with which the Private OFC Custodian is in a controlling entity relationship or in relation to which its associated entity is a linked corporation,
- and that account is not a segregated account; or
- Note: *Linked corporation, in relation to an associated entity of a Private OFC Custodian, means a corporation –*
- (a) of which the associated entity is a controlling entity;
 - (b) which is a controlling entity of the associated entity; or
 - (c) which has as its controlling entity a person which is also a controlling entity of the associated entity;
- (e) pay out of a segregated bank account mentioned in paragraph 2(a) of this Appendix any amount held in the segregated bank account that is not Hong Kong Scheme Money within one business day of becoming so aware.

Securities of the private OFC in Hong Kong

- 3. Where a Private OFC Custodian receives or holds securities on behalf of a private OFC in Hong Kong (“Hong Kong Scheme Securities”), it should:

Note: For the purpose of paragraph 3 of this Appendix, “securities” refers to securities listed or traded on a recognized stock market or interests in a collective investment scheme authorized by the Commission under section 104 of the SFO.

(a) establish and maintain in Hong Kong one or more segregated accounts designated as a trust account or client account for holding the Hong Kong Scheme Securities received by it. Such accounts should be established and maintained with an authorized financial institution in Hong Kong, a custodian approved by the Commission under section 11 of the Securities and Futures (Client Securities) Rules (“CSR”) or another licensed corporation or registered institution licensed or registered for dealing in securities;

(b) ensure that, as soon as reasonably practicable, the Hong Kong Scheme Securities are:

(i) deposited in safe custody in a segregated account; or

(ii) registered in the name of:

A. the OFC on whose behalf the Hong Kong Scheme Securities have been received; or

B. the associated entity of the Private OFC Custodian;

(c) deal with the Hong Kong Scheme Securities that it receives or holds in accordance with:

(i) a written direction for Hong Kong Scheme Securities from or on behalf of the private OFC; or

Note: A “written direction for Hong Kong Scheme Securities” is a written direction given to a Private OFC Custodian by or on behalf of a private OFC directing the Private OFC Custodian to deal with any of the Hong Kong Scheme Securities in a particular manner, such as settlement of a sale order executed for the private OFC by the investment manager of the OFC and applying any of the Hong Kong Scheme Securities in question pursuant to a securities borrowing and lending agreement entered by the private OFC.

(ii) a standing authority for Hong Kong Scheme Securities from or on behalf of the OFC, except where this would:

A. result in a transfer of any of the Hong Kong Scheme Securities to an account in Hong Kong of the Private OFC Custodian or its associated entity; or

B. result in a transfer of any of the Hong Kong Scheme Securities to an account in Hong Kong of any corporation with which the Private OFC Custodian is in a controlling entity relationship or in relation to which its associated entity is a linked corporation;

other than an account referred to in paragraph 3(a) of this Appendix, or otherwise result in the Private OFC Custodian or any corporation with which the Private OFC Custodian is in a controlling entity relationship having the benefit or use of any of the Hong Kong Scheme Securities; or

C. be unconscionable.

Note: A “standing authority for Hong Kong Scheme Securities” is a written notice given to a Private OFC Custodian by or on behalf of a private OFC authorizing the Private OFC Custodian to deal with Hong Kong Scheme Securities from time to time in one or more specified ways.

Linked corporation, in relation to an associated entity of a private OFC Custodian, has the same meaning as set out in the Note to paragraph 2(d)(ii) above.

Other scheme property of a private OFC

4. Where any of the scheme property of a private OFC is not received or held by the Private OFC Custodian or its sub-custodian(s), the Private OFC Custodian should verify that the private OFC or the investment manager of the private OFC has authorized the payments of, transfers of or other dealings with the private OFC’s scheme property.

Sub-custodians

5. Where sub-custodian(s) are appointed, a Private OFC Custodian should have proper oversight over the sub-custodian(s) to enable the Private OFC Custodian to be satisfied that the sub-custodian(s) are suitably qualified and competent in safekeeping any of the private OFC’s scheme property. The Private OFC Custodian should have written internal control policies and procedures for:

- (a) the selection of a sub-custodian for the safekeeping of any of the private OFC’s scheme property, including an assessment of the sub-custodian’s competence, regulatory and financial status, capabilities and internal controls and systems in discharging its delegated obligation of safekeeping of any of the private OFC’s scheme property;
- (b) the ongoing monitoring of such sub-custodian(s); and
- (c) addressing actual or potential conflicts of interests arising from the appointment and oversight of the sub-custodian.

6. Although a sub-custodian may be engaged by a Private OFC Custodian to perform safekeeping of the scheme property of a private OFC, the responsibilities and obligations shall remain with the Private OFC Custodian.

Record-keeping

7. A Private OFC Custodian should keep such accounting and other records as are sufficient to:

- (a) account in the books of the Private OFC Custodian for all of the private OFC's scheme property that:
 - (i) it receives or holds on behalf of each private OFC; and
 - (ii) by its nature cannot be held in custody;
- (b) enable all movements of such scheme property of a private OFC to be traced through its account systems and asset holding system;
- (c) maintain an audit trail of all transactions relating to the scheme property of a private OFC (such as deposits and withdrawals of scheme property) effected by (i) the Private OFC Custodian; (ii) the private OFC; or (iii) the investment manager of the private OFC, all information relating to the accounts of the private OFC showing the details of all movements of scheme property of the private OFC produced by the Private OFC Custodian or third parties and all relevant internal reports and statements of account;
- (d) show particulars of the liabilities, including any financial commitments and contingent liabilities of each private OFC; and
- (e) demonstrate that the Private OFC Custodian has complied with the requirements set out in the OFC Code and all other requirements administered by the Commission which are applicable to the Private OFC Custodian.

8. A Private OFC Custodian which is a licensed corporation should retain records or documents related to its business of safekeeping of the scheme property of each private OFC in premises which have been approved by the Commission under section 130(1) of the SFO for keeping records or documents in relation to the regulated activity for which the Private OFC Custodian is licensed by the Commission. The Private OFC Custodian should retain such records or documents for a period of not less than seven years.

Risk management

9. A Private OFC Custodian must manage custody risk with adequate organisational arrangements to minimize the risks of loss of the scheme property of a private OFC.

General

10. In general, Private OFC Custodians are expected to adopt internal policies and procedures, systems and controls that are substantially the same as those adopted by the Private OFC Custodian for the safekeeping of client assets received or held by the Private OFC Custodian in conducting a regulated activity for which it is licensed by or registered with the Commission (“RA assets”), in particular, in respect of scheme property of the private OFC of the same asset type as the RA assets.
11. For the avoidance of doubt, where a Private OFC Custodian which is licensed for Type 1 regulated activity and provides dealing in securities services to a private OFC receives or holds any client money, client securities and securities collateral on behalf of a private OFC in Hong Kong, it should:
- (a) treat and deal with such client money, client securities and securities collateral in accordance with the applicable provisions of the Securities and Futures (Client Money) Rules and CSR; and
 - (b) keep such accounting, trading and other records in relation to the services provided in accordance with the applicable provisions of the Securities and Futures (Keeping of Records) Rules.
12. In performing its duties of safekeeping the scheme property of a private OFC, to the extent not already covered elsewhere in the OFC Code and this Appendix, a Private OFC Custodian which is licensed by or registered with the Commission to conduct a regulated activity should comply with the applicable provisions of the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Authorized Institutions) as if:
- (a) the holding of each of the private OFC’s scheme property is undertaken in the course of, and as an integral part of its conduct of the regulated activity for which it is licensed by or registered with the Commission; and
 - (b) any reference to client assets, including client money, client securities and securities collateral in the applicable codes and guidelines, included the private OFC’s scheme property.

Appendix II

Key features of the proposed statutory re-domiciliation mechanism for OFCs

- (a) An overseas corporate fund would be required to satisfy the key requirements for the registration of an OFC by the SFC currently applicable to newly established OFCs under the SFO and the OFC Rules. These include the appointment of an investment manager, custodian(s) and directors which fulfill the eligibility requirements under the SFO, OFC Rules and OFC Code, requirements regarding the name, registered office, and instrument of incorporation of an OFC under the SFO and other registration requirements under the OFC Rules.
- (b) The overseas corporate fund would be required to provide registration documents as specified in the OFC Rules including the following:
 - (i) a certificate of registration or incorporation issued with respect to the overseas corporate fund under the laws of the place of incorporation, which should be certified and authenticated in such manner as may be specified by the SFC;
 - (ii) the constitutive document of the overseas corporate fund, which should be certified and authenticated in such manner as may be specified by the SFC; and
 - (iii) a certificate issued by its directors to represent and confirm (1) the fund's solvency²¹; (2) the absence of any petition of winding-up, liquidation, receivership or arrangement or compromise arrangement in respect of the fund; (3) service of notice of the proposed re-domiciliation to its creditors; (4) that any consent or approval for such re-domiciliation and de-registration from its original jurisdiction required by any contract or undertaking given by the fund has been obtained or waived; (5) the re-domiciliation is permitted by and approved in accordance with the fund's constitutive document; and (6) the de-registration of the overseas corporate fund in its place of incorporation is permitted by the laws of that jurisdiction.
- (c) Following the registration of the overseas corporate fund by the SFC, the SFC would notify the Registrar of Companies, which would issue a certificate of re-domiciliation in respect of the overseas corporate fund whereupon the registration by the SFC would come into effect. The business registration certificate for the re-domiciled overseas corporate fund would also be issued by the Registrar of Companies in tandem. This one-stop application and establishment model would be similar to that for the registration and incorporation of OFCs under the SFO currently.
- (d) The registration of an overseas corporate fund as an OFC will not:
 - (i) create a new legal entity;

²¹ This may include for example the provision of a certificate by the directors of the corporate fund after making full inquiry into the affairs of that fund, to confirm the solvency of the fund at that point in time and also that in the directors' opinion, the fund will be able to pay its debts for the 12 months following the date of its application.

- (ii) prejudice or affect the identity or continuity of the overseas corporate fund as previously established and registered under the laws of the place of incorporation for the period that the overseas corporate fund was established and registered in the place of incorporation;
 - (iii) affect any contract made, resolution passed or any other act or thing done in relation to the overseas corporate fund during the period that the overseas corporate fund was so established and registered;
 - (iv) affect the rights, functions, liabilities or obligations, and the property of the overseas corporate fund; or
 - (v) render defective any legal proceedings by or against the overseas corporate fund.
- (e) Any legal proceedings that could have been continued or commenced by or against the overseas corporate fund before its registration may be continued or commenced by or against it after its registration as an OFC.
- (f) It is proposed that the re-domiciled overseas corporate fund's first financial year would begin on the date of its registration as an OFC, and the directors of the OFC may specify a date for the financial year end provided that it falls within 18 months after the date of the overseas corporate fund's registration as an OFC. The subsequent financial years are proposed to be the anniversary of the first financial year.
- (g) The overseas corporate fund would be required to notify the SFC and provide evidence of de-registration in its place of incorporation within a number of days after it is registered as an OFC, failing which its registration with the SFC will be cancelled.
- (h) Fees chargeable in respect of a re-domiciliation of a fund would be generally on par with the registration and incorporation of an OFC currently under the SFO.
- (i) Provided it is satisfied that the key requirements for registration are met²², the SFC may register the overseas corporate fund as an OFC. The SFC may refuse to register the overseas corporate funds if it is not satisfied that the registration is in the interest of the investing public. The SFC may impose conditions on the registration of an overseas corporate fund or the cancellation of its registration.
- (j) The Companies Registry will prescribe the application documents and fees for the issuance of a certificate of re-domiciliation. Such documents and fees would be delivered to the SFC for onward passage to the Companies Registry after the SFC has registered the re-domiciliation of the overseas corporate fund.

²² See paragraph (a) above.