

7 January 2020

Circular to private equity firms seeking to be licensed

This circular provides general guidance for private equity (PE) firms seeking to be licensed by the Securities and Futures Commission (SFC) to carry on a business of regulated activities in Hong Kong under Part V of the Securities and Futures Ordinance (SFO).

The SFC's Licensing Handbook published in February 2019 states that a PE firm may be required to be licensed for one or more types of regulated activities depending on the types of business it conducts in Hong Kong¹. In response to recent queries, the SFC is now providing additional guidance on the following:

- A. Licensing requirements for general partners (GPs)
- B. Discretionary investment authority
- C. Investment committee members
- D. Investments in securities of private companies
- E. Offering co-investment opportunities
- F. Fund marketing activities
- G. Industry experience requirement for responsible officers (ROs)

A. Licensing requirements for general partners (GPs)

It is common for a PE fund to be constituted in the form of a limited partnership. Under this arrangement, a GP assumes ultimate responsibility for the management and control of the fund. In return, the GP would receive management fees, carried interest or other remuneration. In light of the GP's crucial role in managing the PE fund, it is generally required to be licensed for Type 9 regulated activity (RA9) if it conducts fund management business in Hong Kong, provided that the related fund management activities fall under the definition of "asset management" in the SFO. Individuals who perform asset management activities for the GP in Hong Kong are also required to be licensed as representatives and, where appropriate, be approved as ROs accredited to the GP.

However, GPs themselves would not need to be licensed for RA9 if they have fully delegated all of the asset management functions to another entity which is licensed or registered to carry on such regulated activity.

Section 114 of the SFO also prohibits any unlicensed person from holding himself out as carrying on a business in a regulated activity. In particular, an unlicensed GP should not represent to any prospective investor that it manages a PE fund in Hong Kong.

¹ Paragraphs 1.4.18 and 1.4.19 of the Licensing Handbook.

B. Discretionary investment authority

To differentiate RA9 from the regulated activities of advising on securities or futures contracts, the SFC takes the view that licensed asset managers must be granted full discretionary investment authority in respect of the funds they manage². When considering whether a PE firm has this authority, the SFC will look at the facts of each case, including the proposed investment decision-making process, the roles of the proposed licensed individuals (including the ROs) and their involvement in the process, and whether the delegation of investment authority to the firm is properly documented.

For example, the SFC may regard a PE firm as having discretionary investment authority if it proposes to have an RO with sufficient authority and seniority to make investment decisions throughout the life cycle of each fund.

C. Investment committee members

Some PE firms licensed for RA9 have established investment committees in Hong Kong for the funds they manage. Generally speaking, members of an investment committee who, either individually or jointly, play a dominant role in making investment decisions for the funds are required to be licensed as representatives and, where appropriate, be approved as ROs.

Certain investment committee members do not have any voting right or veto power for investment decisions and their primary role is to provide input from a legal, compliance or internal control perspective. These members would generally not need to be licensed.

D. Investments in securities of private companies

Under Part 2, Schedule 5 to the SFO, “asset management” refers to, amongst other things, the provision of a service of managing a portfolio of securities or futures contracts for another person. The term “securities” is given a wide definition in Schedule 1 to the SFO. However, amongst other exclusions, the shares or debentures of a company that is a private company within the meaning of section 11 of the Companies Ordinance (Cap. 622) (CO) are carved out from the definition³.

Many PE funds set up special purpose vehicles (SPVs), incorporated locally or overseas, for investment holding purposes. In determining whether an investment portfolio of a PE fund comprises securities or futures contracts for the purposes of RA9, the SFC will consider the composition of the entire investment portfolio. If underlying investments held through SPVs fall within the definition of “securities” (even if the SPVs are carved out) or the SPVs themselves fall within the definition of “securities”, the SFC will regard the management of the portfolio as “asset management” and the PE firm would be required to be licensed for RA9.

² Paragraph 1.4.24 of the Licensing Handbook.

³ Please refer to sub-paragraph (i) under the exclusions from the scope of “securities” defined in Part 1, Schedule 1 to the SFO and Paragraph 1.4.18 of the Licensing Handbook.

E. Offering co-investment opportunities

If a PE firm offers investment opportunities to other persons whereby they may enter into securities transactions alongside the PE fund, the firm is generally required to be licensed for Type 1 regulated activity (RA1). This is because the act of offering the co-investment opportunities will likely be regarded as inducing other persons to enter into securities transactions.

Nonetheless, the PE firm may not need to be licensed for RA1 if it is licensed for RA9 to manage the PE fund and its act of offering the co-investment opportunities is conducted solely for the purposes of carrying on RA9⁴. For example, if offering co-investment opportunities forms an integral part of fundraising by the PE fund to secure capital to invest in its underlying projects, the PE firm would not be required to be licensed for RA1.

F. Fund marketing activities

As fund marketing activities generally constitute “dealing in securities” as defined in the SFO, a PE firm carrying on a business in such activities would generally be required to be licensed for RA1. However, the licensing exemption discussed in Part E may also apply, where a PE firm which is already licensed for RA9 may market its funds without being additionally licensed for RA1, provided that the related fund marketing activities are conducted by the PE firm solely for the purposes of carrying on RA9.

G. Industry experience requirement for responsible officers (ROs)

In assessing whether an RO applicant of a PE firm has the required relevant industry experience to satisfy competence requirements⁵, the SFC adopts a pragmatic approach and recognises a broad range of experience as long as the applicant can demonstrate that it is relevant to his or her proposed duties. For example, the SFC will consider experience in:

- conducting research, valuation and due diligence of companies in related industries;
- providing management consulting and business strategy advice to companies in related industries;
- managing and monitoring a PE fund’s underlying investments for the best interests of fund investors; and
- structuring corporate transactions, such as management buyouts and privatisations.

The SFC also accepts PE experience gained in a non-regulated situation. It will take into account experience in an overseas jurisdiction where the related PE activities are not regulated, as well as relevant experience in a PE firm which operates in Hong Kong and is exempted from the licensing requirement. For example, such experience may involve conducting research in Hong Kong solely for use by the PE firm’s holding company⁶.

⁴ This exemption from the licensing requirement is based on a carve-out from the definition of “dealing in securities” set out in sub-paragraph (xiv) of such definition in Part 2, Schedule 5 to the SFO.

⁵ For more information about the competence requirements for ROs (including related experience assessments and licensing examination exemptions), please refer to the Guidelines on Competence issued by the SFC and the SFC’s circular dated 11 June 2007 regarding its pragmatic approach to licensing fund managers.

⁶ Paragraph 1.3.14 of the Licensing Handbook.



Should there be queries regarding the contents of this circular, please contact enquiry.pefirm@sfc.hk.

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