



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

Consultation Conclusions on Proposed Enhancements to the Open-ended Fund Companies Regime and Further Consultation on Customer Due Diligence Requirements

2 September 2020

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Foreword

The Securities and Futures Commission (SFC) invites market participants and interested parties to submit written comments on the proposal set out in Part II of this paper or to comment on related matters that might have a significant impact upon the proposal by no later than 5 October 2020. Any person wishing to comment on the proposal 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 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
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong

Re: Further Consultation on OFC Customer Due Diligence Requirements

By fax to: (852) 2877-0318

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

By e-mail to: ofc_2020consultation@sfc.hk

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

Securities and Futures Commission
Hong Kong

2 September 2020

Personal Information Collection Statement

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 - (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.

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5. Personal Data provided to the SFC in response to this 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 Ordinance (Cap. 615).

Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this 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
54/F, One Island East
18 Westlands Road
Quarry Bay, Hong Kong

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

Executive summary

1. On 20 December 2019, the Securities and Futures Commission (SFC) issued a Consultation Paper on Proposed Enhancements to the Open-ended Fund Companies (OFC) Regime (“Consultation Paper”). The proposed enhancements (Proposals) sought to facilitate the adoption of the OFC structure by the industry.
2. The SFC received 13 written submissions, including from industry associations, law and accounting firms, asset management firms and individuals. A list of respondents (other than those who requested anonymity) is shown in **Appendix II**.
3. Respondents were generally supportive of the Proposals. The key comments focused on (1) whether other types of entities could be eligible as private OFC custodians; (2) the investment scope of private OFCs; and (3) whether public OFCs could be exempt from keeping a significant controllers register (SCR). Other comments mainly sought clarification of various technical issues.
4. After carefully considering the comments received and for the reasons listed below, the SFC has adopted the revised Code on Open-ended Fund Companies (OFC Code) with the new Appendix A with modifications or after clarification of the regulatory intent as set out and discussed in this paper.
5. In view of the comments received on the proposed SCR requirements, the SFC is conducting a further consultation on the customer due diligence (CDD) requirements to be imposed on OFCs, which is set out in Part II of this paper.

Key comments on the proposed enhancements to the OFC regime

6. While respondents generally supported the proposal to expand custodian eligibility requirements to allow intermediaries licensed or registered for Type 1 regulated activity (ie RA1 – dealing in securities) to act as custodians for private OFCs, some respondents proposed expanding them further such that other persons including local or overseas intermediaries would also be eligible to act as custodians for private OFCs.
7. The SFC has carefully considered the submissions. For the reasons set out in this paper, the SFC will not further expand the custodian eligibility requirements.
8. Respondents generally supported the proposed expansion of the investment scope of private OFCs to include loans as well as Hong Kong private company shares and debentures. However, many respondents were of the view that investment restrictions were unnecessary and suggested minimising any investment restriction requirements for private OFCs to enhance the competitiveness of the OFC structure.
9. Having considered the specific regulatory powers available to the SFC under the SFO in relation to an OFC and its key operators which would cover activities that may not amount to regulated activities, the SFC is prepared to further relax the investment scope of private OFCs and allow investments in all asset classes the management of which may not amount to a regulated activity (ie providing a service of managing a portfolio of assets other than

securities, futures contracts and, when the relevant legislative amendments come into effect³, OTC derivatives) (“Non-SFO assets”) without any limit.

10. This will put private OFCs on a level playing field with other overseas corporate fund structures⁴ as well as other private fund structures in Hong Kong, including the recently enacted limited partnership funds (LPF)⁵ structure with a view to enhancing the competitiveness of the OFC structure.
11. As such, all investment restrictions on private OFCs under the OFC Code will be removed. On the other hand, new provisions will be included in the OFC Code in this connection to require that investment managers and custodians have sufficient expertise and experience in managing and safekeeping asset classes in which an OFC invests, with corresponding enhancement on risk disclosure in the offering documents, and to keep proper records.
12. Regarding the proposal to require OFCs to keep an SCR similar to the requirements imposed on conventional companies under the Companies Ordinance (Cap. 622) (CO), while a majority of respondents supported the proposal, some respondents asked whether public OFCs could be exempt from SCR requirements. They noted that, given the open-ended nature of OFCs, which are very different from closed-ended conventional companies, these requirements may present difficulties. Other respondents advocated that the same anti-money laundering/counter-financing of terrorism (AML/CFT) requirements should apply to all the different investment vehicles for funds to ensure a level playing field and for practical reasons.
13. Having considered the comments and in view of the recently enacted legislative requirements for LPFs⁶, we propose to align the AML/CFT requirements applicable to OFCs with the LPF regime. This means that instead of requiring OFCs to keep an SCR, OFCs would be required to appoint a responsible person to carry out AML/CFT functions as stipulated under Schedule 2 to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) (AMLO) similar to the requirements imposed on LPFs under the Limited Partnership Fund Ordinance (Cap. 637) (LPFO). By doing so, it is hoped that the AML/CFT requirements applying to different investment vehicles for funds are aligned. The SFC is conducting a further consultation on the CDD requirements to be imposed on OFCs. Details are set out in Part II of this paper.
14. Details of the major comments received and our responses are set out in this paper. We have made various modifications to and clarifications of the revised OFC Code and the new Appendix A. The marked-up texts of the OFC Code are set out in **Appendix I**.

³ The relevant provisions of the Securities and Futures (Amendment) Ordinance 2014

⁴ For example, the Irish Collective Asset-management Vehicle in Ireland, the Open-ended Investment Company in the United Kingdom and the Variable Capital Company in Singapore.

⁵ The Limited Partnership Fund Ordinance (Cap. 637) came into effect on 31 August 2020. The Legislative Council Brief for the corresponding Limited Partnership Fund Bill which was gazetted in March 2020 can be accessed here: https://www.legco.gov.hk/yr19-20/english/bills/brief/b202003201_brf.pdf

⁶ Ibid

Other matters

15. We also received comments that are not within the ambit of the consultation. The SFC notes such comments and will keep them in view. We have relayed the suggestions which are outside the SFC's remit to the relevant authorities for consideration where appropriate.

Implementation

16. The proposals to expand the custodian eligibility requirements for private OFCs and remove the investment restrictions on private OFCs will take immediate effect upon gazettal of the revised OFC Code.
17. The proposal to introduce a re-domiciliation mechanism to enable overseas corporate funds to re-domicile to Hong Kong will take immediate effect upon completion of the legislative process.
18. To help existing private OFC custodians to ensure compliance with the requirements prescribed in the new Appendix A, the SFC will allow these custodians a transition period of six months from gazettal of the revised OFC Code.
19. We would like to thank all respondents for their time and effort in reviewing the Proposals and providing us with their detailed and thoughtful comments.
20. The Consultation Paper, the responses (other than those requested to be withheld from publication) and this paper are available on the SFC website at www.sfc.hk.

Part I – Proposed enhancements to the OFC regime

Custodian eligibility requirements for private OFCs

Question:

1. Do you agree with the proposal to allow intermediaries licensed or registered for Type 1 regulated activity (ie RA1 – dealing in securities) 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 private OFC custodians, RA1 intermediaries which intend to be private OFC custodians and Type 13 regulated activity (ie RA13 – acting as a depository of an SFC-authorized collective investment scheme) 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?

RA1 intermediaries to act as custodians for private OFCs

Public comments

21. Respondents generally supported the proposal to allow RA1 intermediaries to act as custodians for private OFCs, with some respondents noting that many overseas private funds would appoint prime brokers to act as their custodians.
22. Some respondents proposed that other persons should also be eligible to act as custodians for private OFCs, for example, intermediaries licensed or registered for Type 2 regulated activity (ie RA2 – dealing in futures contracts) and Type 11 regulated activity (ie RA11 – dealing in over-the-counter (OTC) derivative products or advising on OTC derivative products), overseas entities subject to equivalent regulation as RA1 intermediaries in their home jurisdiction and trust companies meeting the relevant requirements as RA1 intermediaries.
23. One respondent suggested that there should not be eligibility requirements for custodians of private OFCs. Another noted that no custody is required for OFCs that invest in private equity and venture capital as the investments would be held in the OFC's name. A third respondent noted that most RA1 brokers do not support custodial services for private company shares.

The SFC's response

24. The SFC will proceed with expanding the custodian eligibility requirements to allow intermediaries licensed or registered for RA1 to act as custodians for private OFCs.
25. In proposing the expansion, the SFC considered various factors such as whether the persons proposed to be eligible would have the ability to properly custody and safeguard the scheme property of an OFC and whether the persons are subject to regulatory oversight on an ongoing basis.
26. While intermediaries licensed or registered for RA2 and RA11 would be regulated by the SFC, we note that unlike RA1 intermediaries, RA2 and RA11 intermediaries do not normally perform an incidental securities custodial function when carrying on their respective regulated activities. Indeed, futures contracts are not custodial assets, while an RA11 intermediary typically acts as principal by being the counterparty to an OFC when the OFC transacts in OTC derivatives. This is very different in nature from the agency trades placed by RA1 intermediaries to trade in securities on behalf of their clients. Hence, we do not consider it appropriate to further expand private OFC custodian eligibility requirements to RA2 or RA11 intermediaries.
27. Regarding the suggestion to allow overseas entities subject to equivalent regulation as RA1 intermediaries in their home jurisdiction to act as custodians for private OFCs, we note that such intermediaries are already currently eligible to act as custodians for private OFCs if they meet the requirements in 4.2(d) of the UT Code, such as being authorised to act as a trustee or custodian of a scheme in overseas jurisdictions⁷.
28. With respect to allowing trust companies to act as custodians for private OFCs⁸, an important consideration for the SFC is whether persons proposed to be eligible are subject to regulatory oversight on an ongoing basis. The SFC notes that trust companies in Hong Kong are currently subject to a licensing regime which was designed for AML/CFT regulation but not for regulating custody or safekeeping of assets.
29. As for the suggestion that no custodian is required for OFCs which invest in private equity and venture capital, the requirement that an OFC must have a custodian is a legal requirement pursuant to section 112ZA of the SFO, and is an important investor protection measure. Regardless of the types of assets underlying a private OFC, a custodian must be appointed for safekeeping.

⁷ For example, the Alternative Investment Fund Managers Directive (AIFMD) also requires a depositary to be appointed by an alternative investment fund manager for each alternative investment fund (AIF) it manages. Overseas entities subject to equivalent regulation as RA1 intermediaries in Europe which meet the eligibility requirements to be a depositary of an AIF may act as such subject to acquiring the specific authorisation or approval to act as depositary of a fund in the relevant jurisdiction (as may be required).

⁸ Trust companies are currently eligible to act as custodians for private OFCs if they meet the eligibility requirements in 4.2(b) and 4.2(c) of the UT Code but will become ineligible under the proposed RA13 regime unless they obtain an RA13 licence.

Eligibility criteria applicable to RA1 intermediaries acting as custodian for a private OFC

Public comments

30. Two respondents sought further guidance on the requirement that an RA1 custodian must be independent of the investment manager. One respondent noted that securities and asset management affiliates often share responsible officers and directors (executive and non-executive) and queried whether the RA1 custodian would be considered to be functionally independent of the investment manager in such circumstances. One respondent was of the view that there should be no need to set up two licensed entities just to legally separate the asset management and brokerage/custodian arms.
31. One respondent was of the view that section 112ZA of the SFO imposed a requirement that there can only be a single custodian and a single sub-custodian and noted that this does not reflect market practice. In this connection, the respondent suggested that custodians be allowed to delegate custody tasks to one or more prime brokers.
32. One respondent suggested that additional eligibility criteria should be imposed on an RA1 intermediary applying to be a custodian of a private OFC and suggested the submission of various information such as the responsible officers who would be supervising the custodial function, an updated organisational chart and a custody operational flowchart to assess whether the RA1 intermediary has adequate resources to act as a private OFC custodian.
33. Two respondents proposed a grace period of six months to permit an RA1 intermediary to continue to act as a custodian of a private OFC after the private OFC ceases to be a client of the intermediary in respect of its RA1 business.

The SFC's response

34. In enacting the requirement in the SFO that a custodian be appointed and entrusted with the scheme property of an OFC, the intention was that the custodian must be a separate legal entity from the investment manager of an OFC for investor protection purposes.
35. Regarding the sharing of responsible officers and directors by asset management and securities affiliates, functional independence requires that internal controls be in place to ensure persons fulfilling the custodial function are independent from those fulfilling the investment management functions. This would include ensuring distinct and separate reporting lines.
36. Regarding whether only one custodian and one sub-custodian can be appointed, as mentioned in the 2018 consultation conclusions⁹, the wording of “a custodian” in the SFO can be read as singular or plural and hence does not preclude the appointment of multiple custodians. On the same note, the appointment of multiple sub-custodians is permitted. As such, more than one custodian can be appointed by an OFC, and custodians can delegate their custody tasks to one or more sub-custodians.

⁹ Consultation Conclusions on Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies, May 2018, accessible at: <https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP5>

37. In relation to the suggested additional criteria, we agree that the RA1 custodian should provide details about the responsible officers or executive officers responsible for the overall management and supervision of its custodial function. We have reflected this in the amendments to the OFC Code. This will also enhance SFC's regulatory handle on persons involved in the management of the RA1 intermediary's custodian business. We also agree with the suggestion that the RA1 custodian should provide an updated organisational chart and a custody operational flowchart during the application process.
38. With respect to allowing a grace period for an RA1 intermediary to continue to act as a custodian for a private OFC after it ceases to be the intermediary's client in respect of its RA1 business, the SFC agrees with the suggestion. A grace period of six months will be allowed, and can be extended in exceptional circumstances. The RA1 intermediary should inform the SFC prior to or as soon as practicable upon the private OFC ceasing to be a client and should arrange for the transfer of the private OFC's scheme property to the new custodian as soon as practicable.

Proposed requirements in the new Appendix A to the OFC Code

Public comments – exemption from compliance with Appendix A

39. One respondent suggested that existing trustees and custodians of SFC-authorized funds be exempted from Appendix A as they are not currently subject to the requirements under the Securities and Futures (Client Money) Rules (CMR) and the Securities and Futures (Client Securities) Rules (CSR).

The SFC's response

40. In proposing the requirements in Appendix A to the OFC Code, the intention was to provide more guidance to custodians of private OFCs in relation to the safe-keeping of OFC assets. The underlying principle is to ensure that OFC assets are properly segregated from the assets of the custodian, and if OFC assets are placed in omnibus accounts, that there are proper records to identify the assets as belonging to the OFC with frequent reconciliations. The above is also the underlying principle of the requirements in the CMR and CSR. The specific qualifications to the applicability of the CMR and CSR (eg, that the requirements in the CMR only apply to licensed corporations and not banks) have also been replicated in Appendix A.
41. The SFC notes that the requirements in Appendix A are minimum requirements which all custodians should comply with. Also, as mentioned above, the requirements do not preclude client assets from being held in omnibus accounts. Hence, the SFC believes that custodians which are also existing trustees or custodians of SFC-authorized funds should not have much difficulty in complying.

Public comments – custody of digital assets and unlisted investments

42. One respondent sought elaboration on the custody of digital assets. Respondents also suggested that more guidance be provided on the custody of unlisted investments including shares in private companies.

The SFC's response

43. Regarding investments in digital assets, custodians should assess their expertise, competence, and operational capabilities to ensure that such assets are properly safeguarded and effectively segregated from the custodian's own assets, and that the investment manager of an OFC will not be able to transfer such assets to itself.
44. In relation to unlisted investments, custodians should assess and understand the nature and custody risks of the unlisted investments of an OFC to ensure proper safekeeping of these assets.

Public comments – rehypothecation

45. It was suggested that as prime brokers typically have the right to rehypothecate their private fund clients' assets, an express provision to allow rehypothecation of OFC scheme property should be added to Appendix A.

The SFC's response

46. Regarding rehypothecation of OFC scheme property by prime brokers, we expect that the applicable requirements of the CSR regarding client securities and securities collateral be complied with and Appendix A has been amended to this effect.

Public comments – clarifications of specific Appendix A requirements

47. Separately, a few respondents sought clarification of or made suggestions for the provisions relating to the requirements set out under "Money of the private OFC" (paragraph 2) and "Securities of the private OFC" (paragraph 3) in Appendix A.
48. For example, this included clarification of whether custodians are required to maintain segregated bank or securities accounts for each individual private OFC.
49. Clarification was also sought as to whether subscription money received and held pending the issuance of shares in the relevant private OFC would be considered money of the private OFC and how to comply with the requirement to pay in all amounts of money into a segregated bank account within one business day given the custodians' verification and reconciliation processes.
50. In relation to standing authorities, clarification was requested as to the circumstances which would render it unconscionable to deal in money or securities of a private OFC in accordance with a standing authority, and the persons who would have the authority to issue a written direction or a standing authority on behalf of a private OFC.

The SFC's response

51. Regarding whether custodians are required to maintain segregated bank or securities accounts for each individual private OFC, as mentioned above, Appendix A does not preclude OFC assets from being held in omnibus accounts. In fact, 7.3(d) of the OFC Code expressly provides that OFC assets can be held in omnibus accounts.

52. Subscription money received and held pending the allotment of shares in the relevant private OFC is not the property of the private OFC, and is held on behalf of the subscribing investors until the subscription for shares in the relevant private OFC is accepted. Custodians should keep subscription money in a separate designated collection account pending the allotment of the shares in the relevant OFC. Upon acceptance of the subscription for shares in the private OFC, the custodian should pay the relevant amount into the segregated bank account established pursuant to Appendix A of the OFC Code within one business day. Records of subscription money should be kept separately.
53. In relation to the queries on standing authorities, whether the circumstances would render it “unconscionable” to deal with the relevant OFC scheme property should be decided with regard to the factors specified in section 6 of the Unconscionable Contracts Ordinance (Cap. 458) (UCO), as if the standing authority in question were a contract under the UCO. Who has the authority to issue a written direction or a standing authority on behalf of a private OFC would need to be determined on a case-by-case basis. The custodian will need to be satisfied that the person issuing a written direction or a standing authority has been properly authorised by the private OFC.

Chapter 7 of the OFC Code

Public comments

54. One respondent suggested permitting custodians of virtual assets to become qualified sub-custodians of OFCs under the OFC Code.
55. A few technical comments were also raised regarding the drafting of 7.3 of the OFC Code. A respondent stated that it might not always be practicable for custodians to validate the genuineness of unlisted instruments, OTC papers and private debts, or even verify the ownership of such instruments. The respondent was of the view that custodians should be allowed to disclaim their liabilities for assets which are non-custodial assets as it was of the view that the private OFC or investment manager should be responsible for their safekeeping. The respondent was of the view that 7.3 of the OFC Code should be amended to reflect this.
56. One respondent sought clarification of how common law (fiduciary) duties would apply to the different types of private OFC custodians.

The SFC’s response

57. We have not prescribed any restrictions on the eligibility of sub-custodians appointed by custodians. Under Rule 117 of the OFC Rules, the sub-custodian must take reasonable care, skill and diligence to ensure the safekeeping of the scheme property of the OFC that is entrusted to it. Paragraph 5 of Appendix A requires custodians to be satisfied that any appointed sub-custodian is suitably qualified and competent in safekeeping any of the private OFC’s scheme property and the sub-custodian should be subject to ongoing monitoring.

58. In relation to the suggestions on the drafting of 7.3 of the OFC Code, it should be noted that the requirements under 7.3 of the OFC Code are consistent with the requirements in major overseas fund jurisdictions¹⁰ for the custody of fund assets. Custodians are required to use reasonable care, skill and diligence to ensure the safekeeping of the scheme property of the OFC. This would include ensuring proper records of scheme property are kept with frequent reconciliations.
59. Regarding the suggestion that custodians should be allowed to disclaim their liabilities for non-custodial assets, the applicable standard for custody is set out in section 112ZA of the SFO which reads, “A custodian of an OFC must take reasonable care, skill and diligence to ensure the safe keeping of the scheme property of the OFC that is entrusted to it”. In line with this standard, 7.3 of the OFC Code requires a custodian to be able to exercise control over scheme property. The general principle is that the custodian, and not the investment manager or the board of a private OFC, determines whether particular scheme property can be held and how to hold it. It should also be noted that pursuant to section 112ZC of the SFO, any provision in the instrument of incorporation or any other contract executed by an OFC which purports to exempt the custodian from, or indemnify the custodian against, any liability arising from the custodian’s negligence, default, breach of duty or breach of trust would be void.
60. Finally, with respect to the query about the application of common law (fiduciary) duties to private OFC custodians, the general common law duties would be applicable.

Expansion of investment scope for private OFCs

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.

Public comments

61. Respondents generally supported the proposal to expand the investment scope of private OFCs but many respondents were of the view that investment restrictions were unnecessary. To enhance the competitiveness of the OFC structure, they advocated that there should not be any investment restriction requirements for private OFCs given there are no similar restrictions on private funds constituted in other legal forms in Hong Kong or on other similar corporate fund structures in overseas jurisdictions¹¹.
62. Separately, some respondents sought clarification of the definition of a “portfolio” of securities and futures contracts, with two respondents referencing the SFC’s position that

¹⁰ Please refer to the Standards for the Custody of Collective Investment Schemes’ Assets – Final Report issued by the International Organization of Securities Commissions (IOSCO) on 10 November 2015

¹¹ For example, the Irish Collective Asset-management Vehicle in Ireland, the Open-ended Investment Company in the United Kingdom and the Variable Capital Company in Singapore.

the offering of trading of only one security token on a virtual asset trading platform would bring the platform within the SFC's regulatory net.

The SFC's response

63. The SFC has reconsidered the need for investment restrictions on private OFCs in light of the consultation responses and latest market developments.
64. The SFC notes that specific regulatory powers have been provided for in the SFO in respect of OFCs. Together with other regulatory powers under the SFO, the SFC's powers would cover activities carried on by an intermediary for an OFC whether these activities amount to a regulated activity or not¹². For instance, these would cover misconduct by the investment manager of an OFC that invests entirely in Non-SFO assets. Further, in respect of OFCs, the SFC has the power to approve the investment manager and the custodian, impose registration conditions and cancel registration.
65. Having regard to all the regulatory powers available to the SFC in the regulation of OFCs, including the specific powers referred to in the previous paragraph, the SFC is prepared to further relax the investment scope of private OFCs and allow investments in Non-SFO assets without any limit, as the SFC is satisfied that the regulatory regime for OFCs would be able to cover OFCs that invest in Non-SFO assets, SFO assets or a combination of the two. This will put private OFCs on a level playing field with other overseas corporate fund structures as well as other private fund structures in Hong Kong, including the recently enacted LPFs structure¹³ with a view to enhancing the competitiveness of the OFC vehicle.
66. As such, all investment restrictions on private OFCs under the OFC Code will be removed.
67. On the other hand, new provisions will be included in the OFC Code to require that investment managers and custodians have sufficient expertise and experience in managing and safekeeping asset classes in which an OFC invests, with corresponding enhancement on risk disclosure in the offering documents, and to keep proper records.
68. Investment managers are reminded that under the Fund Manager Code of Conduct, they shall ensure they have sufficient resources and experience for the proper performance of their duties having regard to, amongst other things, the type and nature of assets under their management and the markets in which their OFCs invest. A similar provision will also be added to the OFC Code to require OFC custodians to ensure they have sufficient experience and expertise in safekeeping the assets types in which the OFC invests and to maintain adequate internal controls and systems commensurate with the custodial risks specific to the type and nature of assets in which the OFC invests.

¹² For example, section 182(1) and section 193(1) of the SFO provide the SFC with the power to investigate any misconduct in relation to the management of an OFC or the management or the safe keeping of any scheme property of the OFC and to take disciplinary action for any misconduct that relates to the carrying on of any activity, other than a regulated activity, that an intermediary may carry on for an OFC that is prejudicial to the interest of the investing public or to the public interest.

¹³ The Limited Partnership Fund Ordinance (Cap. 637) came into effect on 31 August 2020. The Legislative Council Brief for the corresponding Limited Partnership Fund Bill which was gazetted in March 2020 can be accessed here: https://www.legco.gov.hk/yr19-20/english/bills/brief/b202003201_brf.pdf

69. Moreover, a note will be added to the OFC Code to remind OFCs to make clear disclosures to their investors on all material risks specific to the type and nature of assets in which an OFC may invest, in particular where the OFC may invest in non-financial or other less common asset classes.
70. It should also be noted that profits tax liability would arise if a private OFC makes investments in certain situations under which the profits tax exemption under the new unified profits tax regime for funds does not apply¹⁴.

Re-domiciliation of overseas corporate funds

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.

Public comments

71. Respondents generally supported the re-domiciliation proposal, highlighting that the process should be as user-friendly, simple, quick, cost effective and legally certain as possible.
72. Two respondents noted that it may only be possible to make certain changes to an overseas corporate fund's structure once there is certainty that the SFC will grant registration of the overseas corporate fund as an OFC and suggested that this "conditionality" be reflected in the re-domiciliation mechanism.
73. Separately, one respondent suggested broadening the coverage by including the restructuring of domestic unit trusts to become OFCs with preservation of the identity, continuity and track record of the fund.
74. Two respondents suggested that the SFC confirm with the Inland Revenue Department that re-domiciliation will not give rise to a Hong Kong profits tax charge if the subject offshore fund satisfies the conditions for the relevant fund exemption regime, as well as that it will not give rise to a Hong Kong stamp duty charge.

The SFC's response

75. Under the proposed re-domiciliation mechanism, an overseas corporate fund can generally be re-domiciled to Hong Kong as an OFC where it satisfies the key requirements for the registration of an OFC currently applicable to newly established OFCs under the SFO and the OFC Rules. These are basic requirements such as the appointment of investment managers, custodians and directors who fulfil the eligibility requirements under the SFO,

¹⁴ For example, under the situations set out in section 20AS of the Inland Revenue Ordinance (IRO).

OFC Rules and OFC Code. For any changes to an overseas fund's structure which would not affect its ability to meet the key requirements, the changes can be effected after re-domiciliation.

76. As noted in the 2018 consultation conclusions¹⁵, there is no restriction on the restructuring of unit trusts into OFCs provided that the relevant requirements for establishing an OFC under the SFO, the OFC Rules and OFC Code are complied with and that such restructuring could be conducted in accordance with the unit trust's constitutive documents. For SFC-authorized funds in unit trust form which are restructured into OFCs with similar investment objective and management, information about their past performance and track records can continue to be used in the funds' advertisements.
77. Upon re-domiciliation, an OFC may enjoy profits tax exemption subject to meeting certain conditions¹⁶. Profits tax liability would arise if a private OFC makes investments in certain situations under which the profits tax exemption under the new unified profits tax regime for funds does not apply¹⁷. It should also be noted that 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 and hence no stamp duty will arise¹⁸.
78. The SFC will proceed with the re-domiciliation proposal which would be effected by introducing new provisions in Part IVA of the SFO and making ancillary amendments to the OFC Rules.

Significant controllers register requirements

Question:

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

Public comments

79. While a majority of respondents supported the proposal regarding SCR requirements, there were also a few comments about the need to ensure a level playing field. One respondent questioned the necessity of an SCR given the existing AML obligations applicable to investment managers of OFCs. Some respondents noted that there are no such

¹⁵ Consultation Conclusions on Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies, May 2018, accessible at: <https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP5>

¹⁶ An OFC is exempted from payment of tax on its profits derived from transactions in assets of both Schedule 16C of the 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 assets of a non-Schedule 16C class with a view to generating income"). See the provisions in sections 20AN and 20AS of the IRO for details.

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

¹⁸ It is based on the assumption that a statutory re-domiciliation mechanism is in place which allows the continuity of the legal personality of the corporate fund.

requirements for funds established in the form of unit trusts. One respondent noted that the proposal would make the use of an OFC more onerous than private unit trusts.

80. Two respondents commented that the requirements should not apply to public OFCs. In this connection, various clarifications were sought in light of the potential difficulties that public OFCs would encounter if they were required to keep an SCR.

The SFC's response

81. The SFC notes the difficulties which would arise from requiring OFCs to keep an SCR given the open-ended nature of OFCs, which are very different from closed-ended conventional companies, and is conducting a further consultation on the CDD requirements to be imposed on OFCs. Please refer to Part II of this paper for the SFC's proposals.

Implementation timeline

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.

Public comments

82. Respondents did not have any objection to the proposed implementation timelines for the expanded custodian eligibility requirements, expanded investment scope of private OFCs and the re-domiciliation mechanism.
83. A few respondents requested longer implementation timelines for the new Appendix A to the OFC Code. One respondent suggested a transition period of three to six months to enable existing private OFC custodians to comply while one proposed an implementation period of 12 months or a grand-fathering arrangement for existing trustees of unit trusts.

The SFC's response

84. The SFC will proceed with the proposed implementation timelines for the expanded custodian eligibility requirements and removal of investment restrictions on private OFCs (immediately effective upon Gazettal of the revised OFC Code) and the re-domiciliation mechanism (immediately effective upon completion of the legislative process).
85. Regarding the new Appendix A to the OFC Code, the SFC will allow a six-month transition period for existing private OFC custodians to comply.

Other comments

86. The SFC also received comments concerning issues not covered in the Consultation Paper. One respondent suggested making a distinction between a closed-ended fund and an open-ended fund. As noted in the 2018 consultation conclusions¹⁹, a “closed-ended” fund is not a legally defined term and generally refers to funds which are subject to redemption restrictions pursuant to which shares or units usually cannot be redeemed at the holders’ discretion. The SFO enables an OFC to have variable capital and does not preclude an OFC from imposing redemption restrictions. As such, a “closed-ended” fund may use an OFC structure. An OFC can also include in its name wording to distinguish itself or otherwise indicate its “closed-ended” nature.
87. Comments were also received on removing requirements for approvals and notifications in the OFC regime. The SFC is of the view that the approvals required are minimal and are necessary to ensure that the basic requirements applicable to OFCs (eg, the eligibility requirements and restrictions under the law) are complied with.
88. Other comments received are not within the ambit of the consultation. The SFC notes such comments and will keep them in view. We have relayed the suggestions which are outside the SFC’s remit to the relevant authorities for consideration where appropriate.

Conclusion and way forward

89. In view of the general support from respondents, the SFC will proceed to implement the revised OFC Code with modifications and clarification of the regulatory intent as set out in this paper. A marked-up version of the amendments to the OFC Code incorporating those discussed in this paper together with other, minor amendments for greater clarity and consistency are set out in Appendix I. The SFC will proceed with the gazettal of the amendments to the OFC Code.
90. The SFC will work on the legislative amendments to effect the re-domiciliation mechanism and enable the winding-up of OFCs to be effected in the same manner as conventional companies in accordance with the phased approach adopted pursuant to the 2018 consultation conclusions²⁰. The SFC is also further consulting on the CDD requirements to be imposed on OFCs which will also be effected by way of legislative amendments. Please refer to Part II of this paper.
91. Once again, the SFC would like to take this opportunity to thank all the respondents for their submissions.

¹⁹ Consultation Conclusions on Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies, May 2018, accessible at: <https://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=17CP5>

²⁰ Ibid

Part II – Further consultation on CDD requirements for OFCs

92. The Financial Action Task Force (FATF) Recommendations require that adequate, accurate and timely information about the beneficial ownership of corporate vehicles is available and accessible by law enforcement agencies. The FATF recognises that this can be achieved through various mechanisms, the keeping of an SCR being one amongst others.
93. While noting that currently, AML/CFT obligations are imposed on the investment managers of OFCs and SFC-licensed or registered intermediaries involved in the sale of OFC shares, we originally proposed to enhance the transparency of corporate beneficial ownership by requiring OFCs to keep an SCR similar to the requirements imposed on conventional companies under the CO. Our aim was to enhance the AML/CFT measures in respect of OFCs in line with FATF principles and requirements.
94. In light of the recently enacted legislative requirements with respect to CDD requirements for AML/CFT purposes applicable to LPFs and the comments received from respondents set out in Part I above, we have decided to reconsider the SCR proposal and further consult on the CDD requirements to be imposed on OFCs.

Further consultation

95. The SFC acknowledges the difficulties which would arise from requiring OFCs to keep an SCR given the open-ended nature of OFCs, which are very different from closed-ended conventional companies. The investors in a public OFC are constantly changing due to the frequent subscription and redemption of shares coupled with the daily redemption feature of public funds. This is particularly the case for public OFCs including exchange traded funds. To require OFCs, and particularly public OFCs, to keep an SCR would likely be unduly burdensome.
96. Regarding the comments on aligning the AML/CFT requirements that apply to different types of investment vehicles for funds, the SFC notes the recently enacted legislative requirements requiring LPFs to appoint a “responsible person” to carry out AML/CFT functions for an LPF as stipulated under Schedule 2 to the AMLO under the LPFO which came into effect on 31 August 2020²¹. The responsible person must be an authorised institution²², a licensed corporation, an accounting professional or a legal professional²³.
97. With a view to aligning the requirements applicable to different types of investment vehicles and noting the difficulties of keeping an SCR for OFCs, the SFC proposes that OFCs should instead be required to appoint a responsible person to carry out AML/CFT functions as stipulated under Schedule 2 to the AMLO, similar to the requirements imposed on LPFs under the LPFO (new CDD requirement).

²¹ The Legislative Council Brief for the corresponding Limited Partnership Fund Bill which was gazetted in March 2020 can be accessed here: https://www.legco.gov.hk/yr19-20/english/bills/brief/b202003201_brf.pdf

²² As defined in the Banking Ordinance (Cap. 155).

²³ For the definitions of “accounting professional” and “legal professional”, please refer to the AMLO.

98. Under the new CDD requirement, the requirements in Schedule 2 of the AMLO would apply to the appointed responsible person in the same manner as they would apply to financial institutions that are currently under the obligation to comply with the AMLO. This would include, for example, provisions governing when simplified customer due diligence can be carried out. In proposing the new CDD requirement, we have soft consulted various industry stakeholders and understand that the requirements should be largely in line with current industry practices.
99. Similar to the original SCR proposal, this new proposal to require OFCs to appoint a responsible person to carry out AML/CFT functions will require legislative amendments. We propose to introduce legislative requirements similar to the requirements imposed on LPFs under the LPFO. In relation to the implementation timeline, again, similar to the original SCR proposal, we propose that there will be a six-month transition period following the completion of the legislative process to allow the industry reasonable time to prepare.

Question:

1. What are your views on the adoption of the proposal to require an OFC to appoint a responsible person to perform AML/CFT functions similar to the requirements on LPFs under the LPFO?
2. Do you have any comments on the proposed implementation timeline?

100. The SFC welcomes any comments from the public on the CDD requirements proposed to be imposed on OFCs. Please submit comments to the SFC in writing no later than 5 October 2020.

Final form of the amendments to the OFC Code

The highlighted parts indicate revisions to the OFC Code which differ from the proposed amendments set out in the Consultation Paper.

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, the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Authorized Institutions) as if all the investment management functions of the OFC are undertaken by the investment manager in the course of, and as an integral part of its conduct of the Type 9 regulated activity for which it is licensed by or registered with the Commission.

6.2B In conducting the investment management functions of the OFC, the investment manager should keep

(a) such trading, accounting and other records as are sufficient to explain and reflect the financial position and operation of the investment manager's activities, including maintaining an audit trail of all transactions effected and contracts entered into by the investment manager, details of all orders initiated by the investment manager or instructions received by the investment manager, details of all income received by the investment manager, whether such income relates to charges made by the investment manager for the provision of services to the OFC, all information relating to the OFC accounts and transaction records produced by third parties and all relevant internal reports, accounting/securities ledgers, registers of securities, and records of investment processes adopted by the investment manager; and

(b) those records in such manner as will enable an audit to be conveniently and

properly carried out.

6.2C An investment manager which is a licensed corporation should retain records or documents related to its business of conducting investment management functions of an 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 investment manager is licensed by the Commission. The investment manager should retain such records or documents for a period of not less than seven years.

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;

Note: Where a private OFC will likely cease, or has ceased to be a client of the licensed corporation or registered institution, the licensed corporation or registered institution should inform the Commission prior to or as soon as practicable following the cessation. A grace period of six months for the licensed corporation or registered institution to continue to act as custodian of the private OFC will be allowed. The licensed corporation or registered institution should arrange for the transfer of the private OFC’s scheme property to another custodian (subject to SFC’s approval) to be appointed in place of the licensed corporation or registered institution as soon as practicable. An extended grace period may be allowed in exceptional circumstances. Early consultation with the Commission is encouraged.

D. have at least one responsible officer or executive officer responsible for the overall management and supervision of its custodial function; and

DE. 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.

7.1A The custodian must:

- (a) ensure that it has sufficient experience, expertise and competence in safekeeping the asset types in which the OFC invests; and
- (b) maintain adequate internal controls and systems commensurate with the custodial risks specific to the type and nature of assets in which the OFC invests.

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.[deleted]~~

~~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.[deleted]~~

- 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.[deleted]~~

~~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.

Chapter 13: Fund operations and disclosure

Fund operations

- 13.1 Fund operations including pricing, dealing, issue and redemption of shares, valuation, distribution policy, use of leverage, fees and charges in respect of a private OFC should be clearly set out in its instrument of incorporation and/or offering documents as appropriate.
- 13.2 In particular, the following principles must be complied with at all times:
- (a) the General Principles;
 - (b) scheme property should be regularly valued in good faith;
 - (c) there should be a proper and disclosed basis for asset valuation, pricing and redemption of shares; and
 - (d) offer and redemption prices should be carried out at forward prices.

Disclosure

- 13.3 The offering documents and other disclosure of an OFC must comply with the General Principles.

Note: This would include ensuring that offering documents contain clear disclosures on all material risks specific to the type and nature of assets in which the OFC is invested, in particular where the OFC invests 10% or more of the gross asset value of the OFC in non-financial or other less common asset class(es).

- 13.4 The offering document must be filed with the Commission (a) as soon as practicable following issuance by the OFC and (b) in the case of changes, within seven days from date of issuance of the revised offering document.

Appendix A

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 an amount held in 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 private OFC, except where (unless permitted under the CSR) this would result in a transfer of any of the Hong Kong Scheme Securities to an account in Hong Kong of:
 - 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.

A Private OFC Custodian which is a Type 1 intermediary may deal with Hong Kong Scheme Securities which are client securities or securities collateral of the intermediary in accordance with section 7 of the CSR.

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, a Private OFC Custodians areis 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, the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and the 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, includesd the private OFC’s scheme property.

List of respondents

(in alphabetical order)

1. Alternative Investment Management Association
2. Charltons
3. CompliancePlus Consulting Limited
4. Deacons
5. Hong Kong Institute of Certified Public Accountants
6. Hong Kong Trustees' Association
7. Hong Kong Women Professionals & Entrepreneurs Association
8. PricewaterhouseCoopers
9. The Hong Kong Institute of Chartered Secretaries
10. Venture Smart Asia Limited
11. Wilson Cheung
12. Submissions of 2 respondents are published on a "no-name" basis upon request