

BRIEFING

Hong Kong Open-ended Fund Companies (“OFCs”) – Common Questions¹

Q: How long does it take to go through the SFC process to register an OFC?

A: In the FAQs relating to OFCs, the SFC states that it is generally expected to take less than one month after the application is taken up by the SFC.

In our experience, the entire process from the first submission of the Application Form for Registration of a Private Open-ended Fund Company or Establishment of a Privately Offered Sub-fund of an Open-ended Fund Company (the “**SFC Application Form**”) takes shorter than one month. Notably, with the benefit of our experience, the time it takes to go through the SFC process has been getting shorter – even as short as less than two weeks.

Q: What are the documents required for the application for registration of a private OFC?

A: For the purposes of registering/incorporating an OFC, the following are required:

1. Certain prescribed forms (e.g. SFC Application Form, SFC Information Checklist, Companies Registry Form, and IRD Form)
2. Instrument of Incorporation
3. Other miscellaneous items, such as a copy of the license certificate of the proposed investment manager, profile of each of the proposed directors, SFC license records of each of the proposed directors (if any), and cheques for application fees, incorporation fees, and business registration fees

Notably, the OFC’s offering documents, the subscription agreement, the investment management agreement and any other agreements which the OFC typically enters into (e.g. fund administration agreement) do not need to be submitted to the SFC for the purposes of registering / incorporating the OFC – these can be prepared in parallel to the SFC application process. However, since the custodian of the OFC needs to sign the SFC Information Checklist, it is important that the custodian is appointed at an early stage to avoid delaying the process. The OFC’s fund administrator does not need to be appointed at the time the application to the SFC is made (in fact, there is no legal requirement to appoint a fund administrator).

Q: Can an OFC be a closed-end fund? For an umbrella OFC, can there be

¹ This article is for private OFCs.

both open-ended and closed-end sub-funds?

A: Yes, despite the name referring to “open-ended”, OFCs may be closed-end, provided that the offering documents of the OFC set out the terms of the redemption restrictions and the OFC’s Instrument of Incorporation contemplates the OFC to be a closed-end fund. This is the case whether the OFC is a single OFC or an umbrella OFC.

Furthermore, an umbrella OFC may have only closed-end sub-funds, only open-ended sub-funds, or a mix of both, and hence the offering documents should clearly delineate whether a sub-fund is open-ended or closed-end and the terms of each sub-fund. This differs from, for example, a Cayman Islands segregated portfolio company (“**Cayman SPC**”) where all sub-funds within the SPC must either be open-ended or closed-end.

Q: Who can be a director of the OFC?

A: Anyone who is “of good repute, appropriately qualified, experienced and proper for the purpose of carrying out the business of the OFC” can be a director of an OFC. Each OFC must have at least two directors, one of whom must be independent (i.e. not a director or an employee of the custodian), and a director may be a director or an employee of the investment manager.

Q: What audit requirements are there?

A: Under the Code on Open-Ended Fund Companies (the “**OFC Code**”), annual reports must be published within four months of the end of the OFC’s financial year. Interim reports (if any) must be published within two months of the end of the period they cover. Whether a report is an “interim report” is determined by reference to the definition of “interim reports” according to the standards the OFC uses to prepare their accounts (e.g. HKFRS, IFRS), which means that, for instance, monthly investor reports should not be considered “interim reports”. All financial reports must be filed with the SFC.

After an OFC has been launched, its first annual report should cover the period commencing from the incorporation of the OFC to the end of its relevant financial year. With respect to an umbrella OFC, as above, its first annual report should cover, in relation to the OFC, the period commencing from the incorporation of the OFC to the end of the relevant financial year, although in relation to the first sub-fund, its financial position and results may start from the sub-fund’s launch date to the end of the relevant financial year (on the assumption that the directors have determined that the start date of the sub-fund’s first financial period is on its date of launch, rather than the date of its establishment).

Q: For an OFC registered with the SFC (and a sub-fund that is established) but not launched, what are the audit requirements?

A: If the OFC has not been launched and therefore has no investor (the “**Conditions**”), it is possible for the OFC to apply for an annual report exemption (“**AR exemption**”) from the SFC to exempt it from the requirements to prepare an annual report for a financial year, publish

the annual report and provide a copy to any shareholder. An OFC is generally not considered to have been launched if it has not received any subscription proceeds for investments. For the avoidance of doubt, management shares, which are non-participating shares, may be issued by an OFC and the OFC is still not considered launched if no investor shares are issued to investors in consideration for subscription monies. Once the Conditions are no longer met, then the AR exemption will lapse and the OFC should notify the SFC in writing immediately.

If a particular sub-fund within an umbrella OFC has not yet been launched after it is established with the SFC, the financial position and results of that particular sub-fund does not need to be disclosed in the annual report because the directors of the OFC can choose whether the start date of a sub-fund's first financial period should be its establishment date or its launch date - no waiver from the SFC needs to be sought for this purpose.

Similar to the above question, a sub-fund is generally not considered to have been launched if it has not received any subscription proceeds for investments and has no investor since its establishment date or the date of re-domiciliation (in the case of an existing sub-fund of a re-domiciled OFC).

Q: What custodian requirements are there?

A: The OFC Code and the Code on Unit Trusts and Mutual Funds (the “**UT Code**”) set out the eligibility requirements of a custodian of an OFC. Most notably, while custodians of public OFCs must meet the eligibility requirements as set out in the UT Code, a custodian of a private OFC may also be a Type 1 licensed corporation, provided that it is not subject to the condition that it shall not hold client assets, amongst other criteria.

The investment manager and custodian of an OFC must be independent, in that while it is possible for an investment manager and a custodian to have the same ultimate holding company, they must be functionally independent. Considerations that are taken into account include the overlap of personnel in the investment manager and custodian (in particular, the directors and responsible officers). It is quite unlikely that the SFC would be satisfied that the investment manager and custodian are functionally independent if the majority of directors and/or responsible officers overlap.

Q: Are there any tax disadvantages of using an OFC versus a Cayman fund?

A: From the Hong Kong profits tax exemption perspective at the fund level, both privately offered onshore and offshore funds operating in Hong Kong may rely on profits tax exemptions pursuant to the Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Ordinance 2019. Therefore, from this perspective, an OFC is treated in the same way as an offshore fund (such as a Cayman fund whose central management and control is outside of Hong Kong). In fact, in addition to enjoying the profits tax exemption on profits earned from transactions in assets of a class specified in Schedule 16C to the Inland Revenue Ordinance (i.e. “qualifying transactions”) and transactions incidental to the carrying out of qualifying transactions (i.e. “incidental transactions”), the OFC may also enjoy the profits tax exemption

on profits earned from transactions in assets of a class that is not specified in Schedule 16C (i.e. “non-Schedule 16C class”) (subject to no percentage threshold) if the OFC does not carry on a direct trading or direct business undertaking in Hong Kong in assets of a non-Schedule 16C class or hold any asset in a non-Schedule 16C class that it utilizes to generate income. This provides a potential tax advantage for those who decide to use an OFC as opposed to, for example, a Cayman fund.

Q: Under the grant scheme, what expenses can be claimed?

A: Eligible expenses must be in relation to the incorporation of an OFC or re-domiciliation of a non-Hong Kong fund corporation. In particular:

1. The service providers must be based in Hong Kong. These include, for example, Hong Kong legal counsel fees, the fund administration on-boarding services, the setup of custody accounts, etc.
2. Statutory fees and application fees are not eligible, including the SFC application fee, Companies Registry incorporation fee, and business registration fee and levy.
3. Fees charged for services rendered for on-going operation of the OFC are not eligible, including fees for annual audits, fees for handling profits tax returns, etc.

Q: How long does the grant scheme application take? What are the main points to note?

A: It takes around one to two months for approval of the grant scheme application, and then a further approximately two weeks for the grant to be deposited directly into the bank account of the investment manager.

Please also note the following points:

- The grant scheme application must be submitted to the SFC within three months from the date of the Certificate of Incorporation or certificate of re-domiciliation;
- Given that the SFC expects that the grant scheme application to be made by the investment manager of the OFC, the investment manager should also be the entity to have paid for all the expenses that are intended to be claimed for the subsidy;
- In the case of an umbrella OFC, the subsidy can be claimed for the costs of setting up more than one sub-fund within that umbrella OFC, provided that those sub-funds were established when the OFC was first registered – any subsequent establishment of sub-funds shall not be covered by the grant scheme; and
- The grant scheme application for each OFC may only be submitted once. Hence, when the grant scheme application is submitted, all outstanding expenses which are intended to be claimed for the subsidy must be paid.

Q: When does the first audit have to be done?

A: An accounting period must not be greater than 18 months – the first accounting period begins on the date of its incorporation and ends on its primary accounting reference date.

This means, for example, if the fiscal year-end of an OFC is to be on 31 December, and if the OFC is incorporated on 1 July 2024, then the first fiscal year-end can be on 31 December 2025 at the latest. However, if the OFC is incorporated on 1 June 2024, then the first fiscal year-end must be 31 December 2024.

Q: Is it possible for one sub-fund to invest into another sub-fund of the same OFC?

A: Yes, a sub-fund of an OFC can invest into another sub-fund of the same OFC. This is different from Cayman SPCs where one sub-fund is not allowed to invest in another sub-fund of the same SPC.

Q: Are there any additional compliance requirements for the investment manager of an OFC and on-going compliance requirements for the OFC?

A: No, there are no additional compliance requirements for the investment manager of an OFC compared to where the investment manager manages a Cayman fund.

The on-going compliance requirements for the OFC are relatively light-touch. There is no need to file annual tax returns to the Companies Registry, but the OFC must prepare an audited annual report and interim reports – please see the question above on audit requirements.

Prior approval from the SFC is required for the following changes:

1. Appointment of director, custodian or investment manager; and
2. Name of the OFC or its sub-fund.

Additionally, once the offering documents have been issued to investors, they should be filed with the SFC as soon as practicable, and in the case of changes, within seven days from the date of issuance of the revised offering documents. Filing involves only emailing the offering documents to the responsible SFC case officer.

Q: Can a standalone Cayman fund be re-domiciled as an umbrella OFC or a Cayman SPC be re-domiciled as a standalone OFC?

A: A standalone Cayman fund cannot be re-domiciled as an umbrella OFC - it must be re-domiciled as a standalone OFC. Whether or not a Cayman SPC can be re-domiciled as a standalone OFC depends on whether the Cayman SPC has any sub-funds. If the Cayman SPC has any sub-funds, then the Cayman SPC must be re-domiciled as an umbrella OFC. However, if the Cayman SPC has no sub-funds, for example, if no sub-funds have been launched or if previously launched sub-funds have all been wound up or terminated, then the Cayman SPC must be re-domiciled as a standalone OFC. Although this is the SFC's official position, we do nonetheless find it slightly odd because, given a Cayman SPC and a Cayman standalone fund (being an exempted limited company) are two different types of legal vehicles, one would expect that a Cayman SPC, even without any sub-funds, should be re-domiciled to a vehicle which is its closest OFC equivalent, which would be an umbrella OFC instead of a standalone

OFC.

Q: After a fund is re-domiciled, do the fund's offering documents need to be amended?

A: If the offering documents are to be issued to any investors or potential investors after the re-domiciliation, the offering documents should be amended; otherwise, there is no need to amend the offering documents (and there are no legal requirements to do so). For example, if the fund to be re-domiciled is closed for new subscriptions, then there is no need to amend the fund's offering documents. However, the constitutional documents of the fund must be amended because the OFC will have an Instrument of Incorporation, as is required in the application for re-domiciliation of a non-Hong Kong fund corporation. The fund's existing Memorandum and Articles of Association (i.e. the fund's existing constitutional documents) cannot be used as the OFC's Instrument of Incorporation without any amendments made to it.

Q: How does the re-domiciliation work on the Cayman Islands side? What deadlines are there?

A: On the Cayman Islands side, the fund must be de-registered with CIMA and de-registered with the Cayman registrar to be transferred by way of continuation to Hong Kong and be re-domiciled to Hong Kong.

One of the important things to note regarding the de-registration with CIMA is that CIMA requires the fund to file its final audited accounts with CIMA. CIMA specifies that these accounts must be made up to the date of re-domiciliation. Given the impracticability of this, an audit waiver should be sought – this should be approved by CIMA provided that the re-domiciliation takes place within six months from the date the last audited accounts are made up to (the “**Deadline**”). As preparing the final audited accounts takes time, the audit waiver should be sought whilst the final audit is being prepared. The auditor should start preparing the final audited accounts as a first step in the re-domiciliation process, so as to avoid any delays in the re-domiciliation process and to ensure that the re-domiciliation process is completed within the Deadline.

Please see below an overview of the steps in the re-domiciliation process:

1. CIMA should be notified regarding the fund's intention to deregister and transfer by way of continuation, and an application should be made for audit waiver from the requirement to file an audited financial report for the period from the day after the audit period to the date of re-domiciliation – i.e. if the financial year end is 31 December, the audit waiver would cover 1 January of the following year to the date of re-domiciliation, which must be within six months of the end of that financial year, being 30 June.
2. The auditors should finalise the final audited accounts up to the financial year end (in the above example, 31 December) (i.e. up to, but not including, the audit period

waived).

3. Once the final audited accounts have been finalised, the auditor must file the fund's final audited accounts with CIMA and the CIMA deregistration application should be submitted – a termination letter from CIMA will be issued once the fund has been successfully deregistered.
4. Simultaneously (as from our experience, it would take some time for CIMA to process the de-registration application), the application for re-domiciliation should be submitted to the SFC – the approval of the application for re-domiciliation by the SFC must be before the Deadline (being 30 June in our example above).
5. Once the SFC approves of the application for re-domiciliation and the certificate of re-domiciliation is issued, the Cayman transfer out documents will be submitted to the Cayman registrar – the Cayman transfer out documents can only be submitted after the de-registration with CIMA has been approved and the fund is registered as an OFC in Hong Kong.
6. The Cayman registrar will issue a certificate of de-registration – this will be on or before the Deadline (being 30 June in our example above).

Q: What are the Cayman Islands-related costs associated with a re-domiciliation of a Cayman fund to an OFC?

A: There will be two categories of Cayman Islands-related costs:

1. Cayman Islands-related disbursements (see further details below)
2. Cayman Islands-related professional fees (e.g. legal fees)

The Cayman Islands-related disbursements would primarily be a de-registration fee equal to three times the annual fee that would have been payable in the January immediately preceding the application for de-registration by the Cayman fund, together with other miscellaneous filing fees and disbursements. For a typical Cayman SPC with an authorized share capital of US\$50,000, the total Cayman Islands-related disbursements would amount to approximately US\$11,000. For a typical Cayman Islands exempted company (i.e. a stand-alone fund) with an authorized share capital of US\$50,000, the total Cayman Islands-related disbursements would amount to approximately US\$3,000 but the exact amounts may vary. These disbursements are not eligible expenses under the grant scheme.

For further details on how we can assist you, please contact us at: info@wbylawyers.com.hk.

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Ben Wong, Principal

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