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BRIEFING

RE-DOMICILIATION OF A CAYMAN ISLANDS FUND AS A HONG KONG OPEN-ENDED FUND COMPANY

INTRODUCTION

The concept of a re-domiciliation of funds from one jurisdiction to another is not a new concept in the international private funds world. However, the re-domiciliation of an overseas fund from another jurisdiction to Hong Kong is a new development currently being proposed, and is made possible following the recent introduction of two Hong Kong domiciled fund vehicles, namely the Hong Kong Open-Ended Fund Company (the "**OFC**") and the Hong Kong Limited Partnership Fund (the "**LPF**"). The implementation of the proposed statutory re-domiciliation process for an overseas fund to an OFC has been confirmed in the "*Consultation Conclusions on Proposed Enhancements to the Open-ended Fund Companies Regime and Further Consultation on Customer Due Diligence Requirements*" issued by the Securities and Futures Commission of Hong Kong (the "**SFC**") on 2 September 2020. It is currently going through the legislative process and is expected to come into effect imminently.

This article answers some of the common questions we have encountered from clients and friends who have expressed interests in the re-domiciliation process for an overseas fund to be re-domiciled as an OFC. Due to the reason that the vast majority of overseas private funds managed by Hong Kong based fund managers are Cayman Islands[1] funds ("**Cayman funds**"), this article will focus on the re-domiciliation of a Cayman fund as an OFC although the proposed re-domiciliation process is not limited to re-domiciliation of a Cayman fund to an OFC – it can apply to any overseas fund so long as the jurisdiction of incorporation of the overseas fund has in place a statutory mechanism for re-domiciliation of funds out of that jurisdiction. Upon re-domiciliation, the overseas fund will no longer by subject to the laws of the jurisdiction where it was incorporated and is no longer subject to payment of any fees relating to the continuation of the fund in that jurisdiction. Instead, it will be subject to HK laws and subject to relevant HK government fees.

For a fund manager already managing a Cayman fund, but is now considering to replace it with an OFC, what are the advantages of using the re-domiciliation process versus establishing a new OFC?

For such a fund manager, the main advantage of using the re-domiciliation process is that there is no need to redeem any of the existing investors' shares in the Cayman fund or liquidate any of

[1] All references to Cayman in this article refer to Cayman Islands

the Cayman fund's investments. The legal basis for this is because the fund continues its legal existence throughout the re-domiciliation process. By the same reason, all the agreements which the Cayman fund has already entered into, for example, the investment management agreement, administration agreement, prime brokerage and custodian agreement, would not need to be terminated and re-entered into solely due to the re-domiciliation of the Cayman fund as an OFC.

What are the procedures involved in the re-domiciliation of a Cayman fund as an OFC?

There are essentially 2 separate sets of procedures and these can be handled simultaneously – one on the Cayman side and one on the HK side. The procedure on the Cayman side is de-registration of the fund by way of continuation. The procedure on the HK side is the re-domiciliation mechanism which is currently being proposed by the HK government.

On the Cayman side, a declaration / affidavit by a director of the fund to be de-registered must be filed which must set out a number of prescribed matters, such as the most current statement of assets and liabilities and any proposed change of name of the fund.

On the HK side, the fund to be re-domiciled as an OFC is required to satisfy the same key requirements for the registration of an OFC by the SFC currently applicable to establishing a new OFC, together with the submission of certain additional information / documents to the SFC, such as:

a) a copy of the certificate of incorporation and the constitutive documents of the existing Cayman fund; and
b) a certificate issued by the fund's directors to confirm various prescribed matters, which may overlap to some degree with those matters covered by the declaration / affidavit by a director required on the Cayman side.

What are the main costs involved?

There will be 4 categories of costs:

1. Cayman related disbursements (see further details below)
2. Cayman related professional fees (e.g. legal fees)
3. Hong Kong related disbursements (see further details below)
4. Hong Kong related professional fees (e.g. legal fees)

The Cayman related disbursements are as follows: -

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 to be de-registered, together with other miscellaneous filing fees and disbursements, must be paid. For a

typical Cayman segregated portfolio company ("**Cayman SPC**") with an authorized share capital of less than US$51,000, the total Cayman related disbursements would amount to approximately US$11,000. For a typical Cayman exempted company (ie a stand-alone fund) with an authorized share capital of less than US$51,000, the total Cayman related disbursements would amount to approximately US$2,900.

The Hong Kong related disbursements are as follows: -

Fees chargeable in respect of a re-domiciliation of a fund would generally be on par with the registration and incorporation of an OFC currently set out under the Securities and Futures (Open-ended Fund Companies) (Fees) Regulation (Cap. 571AR). The current registration fees for a private OFC are as follows:

- HK$10,000 for an umbrella OFC
- HK$1,250 for each sub-fund within an umbrella OFC
- HK$10,000 for a single OFC

As a rule of thumb, we expect that for most funds, it will take between 3 to 6 years for the abovementioned one-off re-domiciliation related costs to be recouped from the on-going cost savings of using an OFC over maintaining a Cayman fund (this would largely depend on, of course, which professional services provider is used and the level of fees they charge).

Do the offering documents (i.e. the Private Placement Memorandum) and constitutive documents of the Cayman fund to be re-domiciled need to be amended?

If the Cayman fund that is to be re-domiciled is a fund with continuous offering (for example, a hedge fund with regular subscription opportunities), then the offering document to be provided to potential investors for the continuous offering should be up to date. Since the offering document used prior to the re-domiciliation would be, post re-domiciliation, out of date, due to the reason that it does not contain information in relation to the fund having been re-domiciled or the changes in the laws and regulations that the fund will be subject to as a result of the re-domiciliation, it should be updated to reflect at least these facts. There is no requirement to file the amended offering documents to the SFC as part of the re-domiciliation procedure. Hence, it is possible that if the Cayman fund to be re-domiciled does not have a continuous offering (for example, if it is a closed end fund where the final closing has already lapsed), the offering documents (if any) for such a fund does not need to be amended as a result of the re-domiciliation of the fund for the reason that the offering documents will no longer be distributed.

It is essential to ensure that investors' consent is sought for the re-domiciliation in accordance with the fund's constitutive documents. This would be the case regardless of whether the

offering documents for the Cayman fund to be re-domiciled is amended as a result of the re-domiciliation. Where, according to the Cayman fund's constitutive documents, investors' consent is not required for the re-domiciliation to occur or where the fund's constitutive documents are silent on this, it would nevertheless be a good practice if investors are notified in advance of the re-domiciliation. Furthermore, for open ended funds, it would also be a good practice to give investors at least one redemption opportunity before the re-domiciliation takes effect.

It should also be noted that, in any event, the existing constitutive documents (ie. the Memorandum and Articles of Association) of the Cayman fund which will be re-domiciled as an OFC will need to be replaced with a new set of constitutive documents, known as the Instrument of Incorporation, for the OFC to be registered as such. The Instrument of Incorporation must contain certain mandatory provisions and hence it is not possible to re-use the existing constitutive documents of the Cayman fund to be re-domiciled without any changes, for the purpose of registering the Cayman fund as an OFC by way of re-domiciliation.

If the existing Cayman fund is a closed end fund (being a fund that is subject to redemption restrictions pursuant to which investors cannot redeem its shares in the fund at its discretion), can it be re-domiciled as an OFC?

Yes, it can, provided that the Cayman fund that will be re-domiciled is in a corporate form (i.e. not, for example, a limited partnership). Despite it being called an "open-ended fund company", there is no reason why an OFC cannot have restrictions on the investors' redemption rights such that it is effectively a closed end fund. In this regard, the OFC (open-ended fund company) is a bit of a misnomer.

Can a Cayman fund which is a single (i.e. stand-alone) fund[2] be re-domiciled as an umbrella OFC and vice versa (i.e. can a Cayman SPC be re-domiciled as a single OFC)?

There is no clear indication from any of the materials issued by the SFC so far as to whether a single Cayman fund can be re-domiciled as an umbrella OFC and vice versa. However, we are of the view that this cannot be done. The reason is that a Cayman single fund (i.e. a Cayman exempted company) is a different type of legal vehicle to a Cayman SPC - a Cayman fund is incorporated either as one or the other. Similarly, an OFC must be established as either as a single OFC or an umbrella OFC upon registration (with the OFC's Instrument of Incorporation reflecting whether it is a single OFC or an umbrella OFC). For this reason, a Cayman SPC should be re-domiciled as an umbrella OFC, and a Cayman single fund should be re-domiciled as a single OFC. For a Cayman single fund in the form of an exempted company to be re-domiciled as an umbrella

[2] i.e. not a Cayman SPC.

OFC, the single (stand-alone) Cayman fund needs to be converted into a Cayman SPC first before it can be then be re-domiciled as an umbrella OFC.

Can a Cayman fund which acts as a feeder fund in a Master Feeder fund structure be re-domiciled as an OFC, leaving the other fund vehicles in such a Master Feeder fund structure unchanged?

Yes, it can. This process is no different to a Cayman fund which does not act as a feeder fund in a Master Feeder fund structure. There is no requirement that all fund vehicles in the entire fund structure (e.g. in a Master Feeder fund structure) needs to be re-domiciled simultaneously. Similarly, a Master Fund in a Master Feeder Fund structure can also be re-domiciled as an OFC whilst the feeder fund(s) remains as Cayman fund(s).

Can a Cayman fund which is in the form of a limited partnership be re-domiciled as an OFC?

No, it cannot. A Cayman limited partnership will need to be re-domiciled as an LPF, when the re-domiciliation mechanism for the LPF is introduced. We expect that the re-domiciliation process for the LPF will be introduced not long after the re-domiciliation process for the OFC comes into effect.

For a fund manager who has decided to launch a Cayman fund for now but wants to leave the option open for it to be re-domiciled as an OFC in the future, what needs to be done?

As a matter of good practice, the fact that the Cayman fund may possibly be re-domiciled as an OFC in the future should be disclosed in the fund's offering documents. Further, the fund's offering documents should also mention the type of approval(s) needed for the re-domiciliation to be effected – for example, does it require the simple majority of holders of investor shares, or is this a matter to be approved by the fund's directors or the holder(s) of (voting) management shares only? The required approval(s) should also be described in the fund's constitutive documents.

Concluding Remarks

Having a fund domiciled in the same jurisdiction as the investment manager and, in so doing aligning form with substance, will increasingly become the fund structuring norm in years to come, not only for Hong Kong based fund managers but also for fund managers based elsewhere,

whether it be EU, Singapore[3], UK[4] or in another jurisdiction. Furthermore, since establishing and maintaining an OFC is far more cost effective than using a Cayman fund, for Hong Kong based investment managers who feel burdened by increasing costs involved in setting up and maintaining a Cayman fund and increasing regulatory requirements from the Cayman authorities, re-domiciling a Cayman fund to a HK OFC would bring a welcome relief. With the opening up of mainland China's financial markets and, based on how the Mutual Fund Recognition Scheme between mainland China and Hong Kong has developed, and also how the proposed Greater Bay Area Wealth Management Connection scheme is likely to develop going forward, it can safely be assumed that any future extension of such schemes to private funds will, at the initial stages, be extended only to Hong Kong domiciled private funds.

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This article is for general information only and is not intended to provide legal advice. Please note that the views expressed in this article is as at the date of the article and may be superseded when the final mechanism for the re-domiciliation process is formally announced. We will update this article if this is the case.

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[3] A foreign fund can be re-domiciled as a Singapore Variable Capital Company

[4] HM Treasury published their "Review of the UK funds regime: A call for input" seeking comments from market participants and other interested parties to improve the UK funds regime, with the intention of "…identifying options which will make the UK an attractive location to set up, manage and administer funds…"