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Newsletter

Financial Services

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What's inside?

Welcome home, offshore funds!

Fiona Fong

Hong Kong will soon allow re-domiciliation of existing offshore funds through amendments to the Securities and Futures Ordinance (**SFO**) for open-ended fund companies (**OFCs**) and the Limited Partnership Fund Ordinance (**LPFO**) for limited partnership funds (**LPFs**). On 1 February 2021, members of the Legislative Council's (**Legco**) Panel on Financial Affairs discussed and were supportive of the proposal that aimed to open the way for existing funds to move to Hong Kong where fund managers are licensed and their substantial activities are conducted. This places Hong Kong in line with the global trend of fund "onshorisation" taking place in many parts of the world.

In Legco's discussion paper, the Hong Kong Government proposes that an existing fund can re-domicile and register as an OFC or LPF if it meets the same eligibility requirements for a new fund under the respective regime. The application process will be straightforward: it will require a single submission of the application documents and application fee to the Securities and Futures Commission to register a non-Hong Kong fund as an OFC; or to the Registrar of Companies in respect of an LPF.

The fund's identity will be preserved upon re-domiciliation, which translates into numerous benefits:

- any contract made or resolution passed will remain intact;
- all rights, functions, liabilities or obligations, and property of the fund before its registration in Hong Kong, will be preserved;
- previous legal proceedings by or against the fund will not be rendered defective; and
- the re-domiciliation does not amount to a transfer of assets or a change in beneficial ownership, hence no stamp duty implications.

Hong Kong is the logical choice for fund managers given its strong community of investors and professional service providers, the proximity to Mainland China and the active initial public offering market for conducting fundraising, deal sourcing and investment management activities. The new proposal puts Hong Kong as a fund domicile in the spotlight again, following the launch of OFC and LPF regimes, as well as the recent draft legislation providing for tax concessions on carried interest.

The SFO and LPFO amendment bills are expected to be introduced for first and second readings before Legco's summer recess this year.

Mainland China briefing: Mainland China, Hong Kong and Macau sign MoU for the Greater Bay Area Wealth Management Connect scheme

Ming Chiu Li and Faye Meng

On 5 February 2021, financial authorities in Mainland China, Hong Kong and Macau, including the People's Bank of China (**PBOC**), the China Banking and Insurance Regulatory Commission (**CBIRC**), the China Securities Regulatory Commission (**CSRC**), China's State Administration of Foreign Exchange (**SAFE**), Hong Kong's Securities and Futures Commission (**SFC**), the Hong Kong Monetary Authority (**HKMA**) and the Monetary Authority of Macau (**AMCM**), jointly signed a memorandum of understanding (**MoU,** available here in Chinese) on the upcoming launch of the wealth management connect (**WMC**) pilot scheme in the Guangdong-Hong Kong-Macau Greater Bay Area. The plan to launch the WMC scheme was announced by the PBOC, the HKMA and AMCM in June 2020 (for more details of the announcement, you may refer to our previous article here).

The MoU consists of seven chapters and 27 articles, covering regulatory information exchange, cooperation in law enforcement, investor protection, and liaison and consultation mechanisms. Key points of the MoU include the following:

(i) Regulation will be based on the jurisdiction where the business is conducted, with an emphasis on compliance with all relevant laws and regulations on wealth management products in Guangdong, Hong Kong and Macau;

(ii) The PBOC, the CBIRC, and the CSRC agree to provide guidance to Mainland banks on the due diligence of eligible wealth management products; likewise, the HKMA, the SFC and AMCM agree to provide such guidance to Hong Kong and Macau banks;

(iii) The cross-border flow of funds will be managed in a closed-loop, exclusively for the purposes of investment through the WMC scheme;

(iv) Measures will be taken to monitor requirements on the aggregate quota and the individual investor quota under WMC; and

(v) Relevant financial authorities will also provide instructions to banks on investor protection, anti-money laundering / counter-financing of terrorism requirements, and personal data protection.

The MoU aims to provide the broader framework for the exchange of regulatory information and cooperation in law enforcement among the regulators in the three jurisdictions. It complements the existing regulatory cooperation among the relevant authorities for the launch of WMC. The signing of the MoU is considered to be of great significance to the implementation of the national strategic plan for the construction of the Guangdong-Hong Kong-Macau Greater Bay Area.

The MoU will take effect upon the launch of WMC, which is widely anticipated to take place in the near future. Although the official rules have not been released yet, the HKMA stated in June 2020 that at the initial stage, eligible products will cover mainly simple investment products of relatively low risk.

The WMC scheme will no doubt strengthen the connectivity of the financial markets of Mainland China and Hong Kong. Further to the mutual recognition of funds, WMC represents a new and flexible channel for Hong Kong fund managers to tap into the opportunities presented by the Mainland market. Fund managers have started to review their existing products or plan for new fund launches to take advantage of the scheme, while bank distributors have been working on the standard terms for offering products to investors. Please get in touch with your usual contact to discuss how Deacons can help you in connection with WMC.

SFC guidance on the appointment of multiple custodians and custody procedures for open-ended fund companies

Fiona Fong and Sarah Lau

On 23 December 2020, the Securities and Futures Commission (**SFC**) updated its Frequently Asked Questions (**FAQs**) relating to Open-ended Fund Companies (**OFCs**) on matters related to custodians and the custody of assets and records of the OFC.

Appointment of multiple custodians

Under the Securities and Futures Ordinance, all scheme property of an OFC must be entrusted to a custodian of the OFC for safekeeping. The SFC clarified that this does not preclude the appointment of multiple custodians. Each custodian is required to hold in its custody such scheme property entrusted to it capable of being held, and for other scheme property entrusted to it which by its nature cannot be held in custody, the custodian would need to maintain a proper record of such property in the account of the OFC in the custodian's books.

Application of subscription monies

The SFC also clarified that any subscription money received by a private OFC pending allotment of shares is monies being held on behalf of subscribing investors and is not the property of the OFC. Custodians need to keep subscription money in a separate designated collection account pending allotment of shares in the OFC. Once subscription in the OFC is accepted, the custodian should pay such amounts into a segregated bank account of the OFC within one business day.

Maintenance of "accounting" records by the custodian of a private OFC

In relation to the duty of a private OFC custodian to maintain proper and up-to-date records of all scheme property it holds or is entrusted to it, the FAQs clarify that such records should enable tracing of all movement of scheme property through the private OFC custodian's systems with frequent reconciliations. It is expected that such records would be sufficient to show particulars of the private OFC's liabilities (including financial commitments and contingent liabilities) and records of items such as holdings, transaction settlement status, corporation actions, cash balances, accrued fees, receivables, payables, and so on should be maintained to facilitate reconciliation.

Aside from the above clarifications, the FAQs also provide an update on the supporting documents required for an application for the appointment of a custodian which holds an SFC licence for conducting type 1 (dealing in securities) regulated activities, including content requirements for the custodian's supporting organisational chart and the custody operational flow chart.

Hong Kong SFC licensing and compliance hints: protecting client assets

Jennifer Baccanello

As mentioned in our article published on 3 April 2020, the deadline for compliance with the Securities and Futures Commission's (**SFC's**) circular of 8 July 2019 on new measures to protect client assets (**Circular**) was extended to 31 January 2021. With these new measures in place, intermediaries are now required to obtain confirmation from authorised institutions (**AIs**) (i.e. banks and deposit-taking companies) with whom they hold client assets that the relevant AI's terms do not provide the AI with recourse to assets in the client's account. Such confirmation should be in the form of a countersigned acknowledgement letter from the relevant AI before depositing any client money or securities into any new client asset accounts.

Under Paragraph 11.1(a) of the Code of Conduct, intermediaries are required to ensure that client assets are adequately safeguarded. Accordingly, the purpose of the Circular's measures is to provide clients with enhanced protection in relation to payment of charges which are incidental to maintaining current, deposit or securities accounts that are client or trust accounts (**Client Asset Accounts**).

The Circular includes a template for the acknowledgement letter which should be adopted and executed by both the intermediary and the AI. The acknowledgement letter will be required where a Client Asset Account is opened with an AI in the name of an intermediary for the purpose of (a) holding client money; (b) holding client securities; or (c) holding non-repledged clients' securities collateral.

Key elements of the acknowledgement letter

1. **Notification of purpose clauses:** states the intermediary's obligation to hold client assets and the purpose for doing so.

2. **No-recourse clause:** prohibits recourse against client assets in Client Asset Accounts. Note that in cases of recourse against assets required by legislation or court order, the no-recourse clause does not apply. Furthermore, should an issuer default, any clawback by an AI of prepaid dividends or interest regarding the issuer's securities would not be considered as recourse against client assets for the purposes of this requirement.

3. **Conflict clauses:** ensures that in the event of any conflict between the acknowledgement letter and any other agreement between the parties in connection with the Client Asset Accounts, the acknowledgement letter shall prevail.

As a final word, the Circular reminds intermediaries that any arrangements for the holding and safeguarding of client assets should be in the best interests of its clients.

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