

# Newsletter

## Financial Services

24 August 2022

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## ETF Connect – limitations and solutions

Pinky Siu

More than one month has passed since the launch on 4 July 2022 of the long-awaited connect scheme for trading exchange-traded funds (**ETFs**) between Mainland China and Hong Kong (**ETF Connect**). While ETF managers have been assessing how they can benefit from the scheme to enhance their cross-border product offering, a few limitations of the ETF Connect scheme are noted.

One of the common concerns is the stringent eligibility criteria, making it quite difficult for an ETF to be included in the scheme. At the initial stage, the Shanghai and Shenzhen stock exchanges have only added four Hong Kong-listed ETFs that can be traded by Mainland investors, and 83 Mainland-listed ETFs can be traded by Hong Kong and international investors via ETF Connect. For details about the ETF eligibility criteria, please refer to our [client alert](#).

In addition to the scope of the ETF Connect being narrow at its initial launch, ETF managers are also wary about the inability for them to market their ETF products. Since ETF Connect is implemented by way of inclusion of eligible ETFs into the existing Stock Connect framework and infrastructure, it is only an expansion of the existing trading facility for mutual access of the Mainland and Hong Kong stock exchanges. In other words, the “connectivity” rests with the secondary market trading only. The ETF Connect scheme itself does not enable cross-border sale and marketing of ETFs.

Having said that, it does not mean that it is impossible to market and offer Mainland-listed ETFs to the public in Hong Kong at all. Under the current regulatory framework, fund houses that wish to bring their Mainland-listed ETFs to the Hong Kong retail market will need to get their funds authorised by the Securities and Futures Commission (**SFC**) in Hong Kong. The following traditional means remain available to them:

- **Mainland-Hong Kong mutual recognition of funds (Mainland-HK MRF):** Index-tracking ETFs fall within the scope of Mainland-HK MRF. As confirmed in the [Frequently Asked Questions on Mainland-HK MRF](#) published by the SFC, Mainland-HK MRF allows investors in the host jurisdiction to make primary subscription and redemption of a fund (including an ETF) approved or authorised in the home jurisdiction, subject to the relevant laws and regulations and its constitutive documents. If the relevant Mainland-listed ETF seeking the SFC's authorisation in Hong Kong is a physical index-tracking ETF tracking an index which is adopted by another existing SFC-authorized fund or is a plain vanilla index, such application for authorisation of the Mainland-listed ETF can be processed as a standard application, subject to fulfilment of other criteria.

- Streamlined measures for ETFs adopting a master-feeder structure: As discussed in our earlier article (available [here](#)), the SFC is prepared to allow an SFC-authorised feeder ETF to invest its assets in an overseas-listed master ETF without the latter obtaining the SFC authorisation. In this connection, the master ETF must be a scheme regulated in a recognised jurisdiction managed by a management company in an acceptable inspection regime or a scheme eligible under a mutual recognition of funds arrangement. A Mainland-listed ETF being eligible under Mainland-HK MRF may therefore be able to rely on the streamlined measures provided other conditions are also met. It means that fund managers can set up and seek the SFC's authorisation of a Hong Kong feeder ETF which feeds into a Mainland-listed ETF, even though the Mainland-listed ETF is not authorised by the SFC in Hong Kong.

## Regulatory updates on investments in virtual assets and insurance-linked securities by SFC-authorised funds

Eve Leung

On 8 July 2022, Hong Kong's Securities and Futures Commission (**SFC**) issued new guidance and requirements regarding investments in virtual assets and insurance-linked securities (**ILS**) by SFC-authorised funds.

### *(a) Investments in virtual assets*

The SFC stated that authorised funds are not expected to invest directly in virtual assets. Management companies should consult the SFC in advance if their funds may have any indirect investment in or exposure to virtual assets. Such indirect investment or exposure should not be more than 10% of the relevant fund's net asset value and should be consistent with the objectives, investment strategy and the overall risk profile of the fund.

### *(b) Investments in ILS and ILS-related products*

The SFC clarified that authorised funds are prohibited from investing in ILS issued in Hong Kong and their repackaged products and derivatives. ILS means securities issued through insurance securitization, e.g. catastrophe bonds. An SFC-authorised fund may invest in ILS issued outside Hong Kong and/or any ILS-related products, subject to an investment limit of not more than 10% of the fund's net asset value. The fund should disclose in its key facts statement (**KFS**) the types / examples of such ILS investments together with its expected total investment limit. The risks associated with ILS investments should also be disclosed in the offering document. The fund's management company is required to put in place suitable and adequate risk management and control systems to monitor and manage all risks relevant to such investments.

Management companies of existing authorised funds are required to update / enhance their offering documents (including the KFS) in accordance with the above requirements as soon as reasonably practicable and at the next earliest opportunity if the funds may invest in ILS.

In light of the new requirements, management companies should review the investment policies of their authorised funds in respect of the above investments as soon as possible and consider whether any updates or enhancements are necessary. They should consult the SFC if there are any questions.

The SFC has updated the following documents to provide further guidance on the above investments. The SFC's information checklist for new fund application has also been enhanced to include confirmations relating to such investments.

- [Guide](#) on Practices and Procedures for Application for Authorisation of Unit Trusts and Mutual Funds
- [Frequently Asked Questions](#) on the Code on Unit Trusts and Mutual Funds
- [Information Checklist](#) for Application for Authorisation of Unit Trusts and Mutual Funds under the Revamped Process

# Practical tips on requirements relating to an OFC's registered office

Fiona Fong

Every open-ended fund company (**OFC**) must appoint and maintain a registered office situated in Hong Kong, pursuant to the requirements in the Securities and Futures Ordinance Chapter 571 (**SFO**), the Securities and Futures (Open-ended Fund Companies) Rules Chapter 571AQ (**OFC Rules**) and the Securities and Futures Commission's (**SFC**) Code on Open-ended Fund Companies (**OFC Code**).

This article outlines what is an OFC's registered office and its duties, and the steps involved in changing a registered office, and comments on common market practice.

## *What is a registered office?*

A registered office is where all communications and notices to the OFC may be addressed.

During an application for registration of an OFC, the address of the place which is to be the OFC's registered office must be specified on the Application Form to be submitted to the SFC and the OFC Incorporation Form (**OFCNC1**) to be submitted to the Companies Registry (**CR**). The address stated on the OFCNC1 form is automatically regarded as the address of the registered office. Non-Hong Kong addresses, 'care of' addresses or post office box numbers are not acceptable.

Shareholders of an OFC may also find that the registered office is typically stated in the OFC's Instrument of Incorporation (or at least a statement that the registered office of the OFC is situated in Hong Kong) and the OFC's offering documents. The registered office address must be disclosed on every letter from the OFC, in each agreement entered into by the OFC, in every other document issued by the OFC in the course of its business, and on any website of the OFC.

The registered office of an OFC is searchable at the CR on the Register of Open-ended Fund Companies. The public can order image records or certified copies of image records of the OFCNC1 form that contains such information.

## *What does a registered office do?*

### **Receipt of service of notices**

Communications and notices may be addressed to the OFC's registered office. For example, the Inland Revenue Department will send a renewal demand note for the OFC's business registration to the OFC's registered office. The registered office will receive a renewal demand note from the Inland Revenue Department approximately two weeks before the Business Registration Certificate needs to be renewed.

Subject to any agreement or overriding provisions to the contrary, any written notice, direction or document served on the OFC would be regarded as duly served if it is left at or posted to the registered office in Hong Kong.

### **Safekeeping of registers and records**

The OFC Rules outline that the OFC's register of shareholders, register of directors and all records of resolutions and meetings must be kept at its registered office, or an alternative place in Hong Kong notified to the CR. A Notice of Location of Registers and Records (OFCR2) must be in the specified form (which can be downloaded from the CR's website) and delivered to the CR for registration within 15 days after the change. If the registers and records are kept at the registered office at all times since the OFC's inception, the OFC is not required to notify the CR.

Failure to comply with the above requirements is an offence and is liable on conviction to a fine. A further daily fine may also be imposed in the case of a continuing offence.

The OFC Rules further provide that a shareholder of an OFC is entitled, on request and without charge, to inspect entries of the OFC's register of shareholders (in respect of information relating to such shareholder) and the register of directors.

### *Change of registered office*

If the address of an OFC's registered office is changed, the OFC must deliver to the CR for registration a Notice of the Change of Address of Registered Office (OFCR1) in the specified form (which can be downloaded from the CR's website), within 15 days after the change.

Failure to do so is an offence and is liable on conviction. A further daily fine may also be imposed in the case of a continuing offence.

For an overseas corporate fund re-domiciling to Hong Kong and registering as an OFC, the registered office of the re-domiciled OFC will need to be moved from its place of incorporation to an address in Hong Kong. The new Hong Kong address must be stated in the re-domiciliation form (i.e. Application Form for Registration of a Non-Hong Kong Fund Corporation as a Re-domiciled Open-ended Fund Company to be submitted to the SFC), which will be regarded as the address of the registered office of the fund upon the re-domiciliation taking effect.

All current registers and past records of resolutions and meetings of the re-domiciled OFC must be transferred from its place of incorporation to Hong Kong.

### *Market practice*

Based on our observations, most private OFCs appoint the address of its investment manager (**OFC Manager**) as the registered office. This arrangement is different from the market practice for offshore funds, where the registered office function is often outsourced to local service providers in the offshore fund's domicile. One of the benefits of reducing the need to outsource is to save operating costs otherwise payable to service providers. Keeping the registered office at the same address as the OFC Manager also means that the OFC Manager will have timely access to notifications sent to the OFC, its registers and other statutory records. This arrangement facilitates the operation of the OFC by the OFC Manager as a key operator.

Having said that, it is not uncommon for fund administrators to continue maintaining registers of shareholders for OFCs.

If an OFC Manager would like professional help in the custody of documents and other general corporate services, Deacons offers a cost-effective solution.

## Webinar invitation

### **Step forward: Q&A on setting up a Hong Kong open-ended fund company (OFC)**

**更进一步：香港 OFC 基金设立有问必答**

**Date: Tuesday, 30 August 2022**

**Language: Mandarin**

#### Online event

Time: 16:00 – 17:00 HKT

Venue: Online

#### In-person event

Time: 15:45 – 18:00 HKT

Venue: Jing'an District, Shanghai

#### Agenda

- new types of investment funds
- issues on domicile and fund structures
- overview and advantages of the OFC
- Cayman funds v OFCs
- trends and case studies
- comparing costs

- OFC application process
- practical tips and common mistakes
- steps for re-domiciling overseas funds to Hong Kong
- tax issues and compliance practices
- grant scheme

Speakers:

Fiona Fong, Partner, Deacons

Erin Wu, SVP, Head of Investor Relations, OP Investment Management

Fiona Tse, Associate Director, Investment Products, Securities and Futures Commission

Sandy Fung, Tax Partner, Alternative Investments, Hong Kong, KMPG China

For registration, please visit OP Investment Management's event web page at <https://opim.ac-page.com/20220830-hkofo>.

## Recent publications

[Hong Kong Monetary Authority's \(HKMA\) Guide to Authorisation](#)

[Court considers measure of damages for breach of contract for services](#)

[Court rules on construction of "null and void clause" in surety bond](#)

[Court sets out relevant principles when considering question of interest payable on judgment sum](#)

[The Bank of International Settlements publishes report on use of central bank digital currencies in cross-border projects](#)

[Discussion paper on e-HKD from policy and design perspective](#)

[Market guidance issued by ISDA for SOFR swap effective dates](#)

[Regtech Knowledge Hub](#)

[HKMA's sixth issue of the Regtech Adoption Practice Guide](#)

[China's Draft Specification on Certification Technologies for Cross-border Personal Information Processing Activities](#)

[Stamp Duty Alert: District Court holds that Limited Liability Partnerships may be associated bodies corporate for s.45 intra-group relief](#)

[The Measures for the Security Assessment of Outbound Data promulgated officially](#)

[Pro-female bias in sexual harassment complaint? A lesson for the employer](#)

[New requirements on share option / award schemes to take effect on 1 January 2023](#)

[International tax alert: certificates of resident status \(CoR\) in Hong Kong](#)

[Complying with China's cross-border data transfer rules](#)

[Variation of works – a reminder to comply with contractual requirements](#)

[FamilyFocus@Deacons: Series on Mainland/Hong Kong Cross-Boundary Marriages – Article 1](#)

[Proprietary relief granted to victims of cryptocurrency fraud](#)

Pro-female bias in sexual harassment complaint? A lesson for the employer

Court of Final Appeal clarifies the second core requirement to wind up foreign company

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