HEDGE FUNDS

Hong Kong

LEXOLOGY
Getting The Deal Through

Consulting editor
Sidley Austin LLP

Hedge Funds

Consulting editors

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Quick reference guide enabling side-by-side comparison of local insights, including into the market and policy climate; formation and management; regulation, licensing and registration; taxation; offering, selling and trading restrictions; liquidity terms; and recent trends.

Generated 07 July 2022

Table of contents

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Hong Kong

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MARKET AND POLICY CLIMATE

Market snapshot

How would you generally describe the state of the market for hedge funds in your jurisdiction?

Hong Kong has been positioned as Asia's pre-eminent asset management hub for decades, and its hedge fund market has continued to grow steadily. According to HFM, the Billion Dollar Club (BDC) firms in Hong Kong collectively managed US$120 billion of assets in 2020 and there had been a notable increase in BDC members within the year, from 30 to 43.

To strengthen this position further and develop the domestic hedge fund market, the Hong Kong government introduced a new form of company in 2018, the open-ended fund company (OFC), in an attempt to provide fund sponsors with a more attractive corporate platform. Hong Kong's government further reformed the OFC structure in 2020 and 2021. These changes have resulted in a steady increase in the popularity of OFCs among fund sponsors and asset managers based in Hong Kong. While there were only five registered OFCs in September 2020, there are now 50 OFCs (comprising 179 funds and sub-funds) as at April 2022.

Law stated - 30 June 2022

Government and regulatory policy

How would you describe the general government and regulatory policy towards hedge funds in your jurisdiction?

The Hong Kong government and its market regulators have been generally supportive of the hedge fund industry, as exemplified by the 2020 reforms to the OFC regime and the implementation of a government subsidy of up to HK$1 million for OFCs that are established in Hong Kong.

Law stated - 30 June 2022

FORMATION AND MANAGEMENT

Forms of vehicle

What legal form of vehicle is typically used for hedge funds formed in your jurisdiction? Does such a vehicle have a separate legal personality or existence under the law of your jurisdiction? In either case, what are the legal consequences for investors and the manager?

The majority of hedge funds that are managed in Hong Kong are organised in the Cayman Islands. However, since the introduction of the open-ended fund company (OFC) regime in 2018, and subsequent reforms made in 2020 and 2021, the OFC is becoming a more popular vehicle for hedge funds managed in Hong Kong.

An OFC is an open-ended fund organised in corporate form and domiciled in Hong Kong. It is similar in structure to a Cayman Islands segregated portfolio company. Being a corporate entity, the OFC has a separate legal personality, and, therefore, the fund manager does not assume unlimited liability for the debts and obligations of an OFC.

The shareholders of an OFC have limited liability and are not liable for the debts of an OFC beyond the amount of capital that they have agreed to contribute in the form of their subscription to the OFC.

An OFC can segregate the liability of multiple portfolios within each portfolio that is attributable to a separate sub-fund. The liabilities of each sub-fund are also segregated from each other sub-fund within the OFC structure under Hong Kong law.

Law stated - 30 June 2022

Formation process

What is the process for forming a hedge fund vehicle in your jurisdiction?

The establishment of a Hong Kong domiciled hedge fund under the OFC regime is a two-step procedural process. First, an application must be submitted to the Securities and Futures Commission (SFC), which processes registrations for and oversees the establishment of, OFCs in Hong Kong. Secondly, a submission must be made to the Companies Registry (CR), which is responsible for processing the corporate filings related to, and the incorporation of, the OFC.

To establish an OFC, the following must be obtained:

- registration of the OFC by the SFC;
- a certificate of incorporation issued by the CR; and
- a business registration (BR) certificate issued by the CR on behalf of the Inland Revenue Department (IRD).

The application for the establishment of an OFC in Hong Kong that is submitted to the SFC for approval of a private or public OFC must include the following:

- a duly signed and completed application form;
- a duly signed and completed information checklist;
- a copy of the instrument of incorporation signed by each of the proposed directors;
- documents (including any confirmations or undertakings) required to be submitted pursuant to the information checklist; and
- the prescribed fees (see below).

Once the SFC has approved the application, it will forward the application documents required for the incorporation and business registration of the OFC to the CR for further processing.

The SFC has indicated that successful applications for private OFCs will generally be approved in less than one month following acceptance of the application by the SFC (ie, from the time that all the required documents are forwarded to, and accepted by, the SFC). The processing of applications for public OFCs will generally take one to three months depending on their complexity. The SFC's registration takes effect when the CR issues a certificate of incorporation.

The CR generally takes three business days to issue the certificate of incorporation for an OFC following receipt of the application documents and the prescribed fees from the SFC.

The fees payable to the SFC for registration of an OFC are:

- HK$10,000 for the application where the intended OFC has one or more sub-funds and a further HK$1,250 for each sub-fund; and
- HK$5,000 in any other case.

The fees payable to the CR for incorporation and for BR purposes are as follows:

- the fee payable to the CR for the incorporation of an OFC is HK$3,034, inclusive of a non-refundable lodgement fee of HK$479; and

- with respect to the BR application, for a one-year BR certificate, the fee is currently waived by the government. However, a levy of HK$250 remains applicable. For a three-year BR certificate, a fee of HK$5,950 is applicable, inclusive of a levy of HK$750.

The websites of the CR and the IRD will provide updates concerning future fee waivers that may be applicable from time to time.

There are no minimum capital requirements for an OFC.

Law stated - 30 June 2022

Custodianship and administration

Is a hedge fund vehicle formed in your jurisdiction required to maintain locally a custodian or administrator, a registered office, books and records, or a corporate secretary? If so, how is that requirement typically satisfied?

An OFC established under applicable Hong Kong law is required to have a registered office in Hong Kong, and to appoint an investment manager and custodian. There are book and record-keeping requirements that are applicable, as set forth in the SFC's Code on Open-Ended Fund Companies (the OFC Code).

The assets of an OFC are required to be held by an independent custodian. An OFC custodian is required to maintain proper and up-to-date records of all scheme property of the OFC that it receives or holds on behalf of the OFC and other assets that cannot be held in custody. Where the custodian is a foreign entity that is not a registered non-Hong Kong company, it must appoint and maintain a process agent in Hong Kong at all times for the purpose of accepting the service of notices and documents in Hong Kong.

The investment manager of an OFC is required to keep such trading, accounting and other records of the OFC sufficient to explain and reflect the financial position and operation of the OFC's activities in premises approved by the SFC for not less than seven years. These records must be maintained in such a manner as will enable an audit to be conveniently and properly carried out.

An OFC is not required to appoint a local or overseas administrator or a corporate secretary. However, there are specific corporate administrative matters that need to be satisfied by an OFC, as set forth in the OFC Code. The matters outlined below are required to be set forth in the instrument of incorporation, including:

- the procedures and notice requirements for holding general meetings and directors' meetings, the exercise of voting formalities and the quorum required, the matters that require approval, the thresholds for and manner of securing approval and any related record-keeping requirements;
- the creation of shares and share classes (if any), the rights attached to the shares, the terms for issuance and the cancellation of shares;
- the requirement that a minimum of two shareholders must be present in person or by proxy to constitute a quorum of a general meeting of an OFC; and
- in the case of an OFC that provides in its instrument of incorporation that it will convene annual general meetings, a provision that at least 21 days' notice will be provided before holding such a meeting.

The offering document of an OFC must stipulate the manner in which the shareholders of an OFC may obtain relevant information and make enquiries concerning the OFC. Corporate filings that are subject to approval by the SFC must be filed with the SFC for onward transmission to the CR following approval by the SFC.

Law stated - 30 June 2022

Public access to information

What access to information about a hedge fund formed in your jurisdiction is the public granted by law? How is it accessed? If applicable, what are the consequences of failing to make such information available?

The list of registered OFCs organised under the Hong Kong regime (listed or unlisted, private or public) is available on the SFC's website . The list contains the name of an OFC, the corresponding umbrella fund, the name of each sub-fund (if applicable), the investment manager and the authorisation date. Information concerning the identity of investors and the amount or value of their investment is not publicly available.

A shareholder of an OFC has the right to inspect the OFC's register of shareholders, which must be maintained by the OFC and contain the following information:

- the name and address of the shareholders;
- the date on which each person is entered in the register as a shareholder;
- the date on which any person ceases to be a shareholder;
- a statement of the shares held by each shareholder, distinguishing each share by its number (if relevant), and the sub-fund and share class of each sub-fund, as applicable, to which each share belongs; and
- the amount paid or agreed to be considered as paid on the shares of each shareholder.

A shareholder of an OFC can also request from the OFC a copy of all the entries in the register of shareholders at no charge.

If an OFC fails to maintain the register, or update the register within two months following the date of issue of any share or change in a shareholder's particulars, it commits an offence and is liable on conviction to a fine of HK$25,000. In the case of a continuing offence, a further fine of HK$700 may be levied for each day during which the offence continues.

The following information concerning an OFC is available online at the CR's Cyber Search Centre :

- CR incorporation form, which provides the directors' details and the registered office address in Hong Kong;
- instrument of incorporation; and
- certificate of incorporation.

There is no charge levied to conduct searches on and to view the index of documents available in relation to an OFC in the Cyber Search Centre. To view or download a document on record, a fee ranging from HK$9 to HK$29 is applicable, depending on the type of document. The fees section of the CR website sets forth the details of the amount payable for each type of document.

Law stated - 30 June 2022

Third-party investor liability

In what circumstances would the limited liability of third-party investors in a hedge fund formed in your jurisdiction not be respected as a matter of local law?

Shareholders do not usually have personal liability for the debts of an OFC organised under Hong Kong law beyond the amount of capital that they have agreed to subscribe in accordance with section 112Q of the Securities and Futures Ordinance (Cap 571) (SFO). However, personal liability may arise where a shareholder has provided a personal guarantee for the debts of the OFC or has been complicit in fraudulent activity in relation to the management of the OFC's assets or business.

Law stated - 30 June 2022

Fund manager's fiduciary duties

What are the fiduciary duties owed to a hedge fund formed in your jurisdiction and its third-party investors by that fund's manager (or other similar control party or fiduciary) under the laws of your jurisdiction? To what extent can those fiduciary duties be modified by agreement of the parties?

An investment manager that is responsible for the management of a public or private OFC organised in Hong Kong is expected (at a minimum) to adhere to the following seven general principles (GPs) that are prescribed under the OFC Code. These principles are fiduciary in nature and are owed to the OFC and their third-party investors when administering, managing or dealing with any matters relating to the operation of an OFC:

- GP 1 – Acting fairly: key operators (meaning the director(s), investment manager and custodian of each OFC) must act honestly, fairly and professionally.
- GP 2 – Diligence and competency: key operators must discharge their functions with due skill, care and diligence. Where a delegate is appointed, due care must be exercised by the key operator in the selection, appointment and ongoing monitoring of the delegate.
- GP 3 – Proper protection of assets: all the scheme property of an OFC must be entrusted to the custodian and properly safeguarded.
- GP 4 – Managing conflicts of interest: key operators must avoid situations where conflicts of interest may arise, including any actual or potential conflict between different parties in respect of an OFC. Where conflicts of interest cannot be avoided, and provided that the interests of investors can be sufficiently safeguarded, the conflict must be managed and minimised through the use of appropriate safeguards, measures and the product structure, all of which must be properly disclosed to investors. The board of directors must uphold good corporate governance principles and standards for their activities conducted in relation to the OFC.
- GP 5 – Disclosure: disclosure must be clear, concise and effective, and must contain the up-to-date information necessary for investors to be able to make an informed judgement in relation to the investment proposed to them. Where ongoing disclosure is required, information must be disseminated in a timely and efficient manner.
- GP 6 – Regulatory compliance: the OFC and its key operators must ensure compliance with applicable regulatory requirements, and respond to enquiries from regulators in an open and cooperative manner. They should also inform the SFC promptly should there be any material breach of the OFC Code.
- GP 7 – Compliance with constitutive documents: the OFC and relevant key operators must comply with the instrument of incorporation and offering documents of the OFC.

It is important to note that the applicable regulatory requirements under GP 6 include the Fund Manager Code of Conduct (FMCC). The FMCC establishes the baseline standard of conduct that is applicable to all persons licensed by or registered with the SFC, including their representatives, whose business involves the management of collective investment schemes (whether authorised or unauthorised) or discretionary accounts (in the form of an investment mandate or predefined model portfolio) (fund managers). Certain requirements (as specifically set forth in the FMCC),

however, are only applicable to a fund manager that is 'responsible for the overall operation of a fund'.

Most notably, where a fund manager is responsible for the overall operation of a fund, as is typically the case for an OFC, it is required to make an adequate disclosure of information (as well as any material change to the information) concerning the fund, which is necessary for investors to be able to make an informed judgement regarding their investment in the fund. This includes the responsibility to ensure that an independent auditor is appointed to perform an audit of the financial statements of the fund (whether by appointing the independent auditor or procuring the relevant fund to appoint the independent auditor) to make available, at a minimum, an annual report for each of the funds under management. The annual report for each of these funds should also be made available to investors in the relevant funds upon request.

Law stated - 30 June 2022

Management liability and negligence

What standard of liability applies to the management of a hedge fund formed in your jurisdiction? Does your jurisdiction recognise 'gross negligence' (as opposed to 'ordinary negligence') in this regard?

Each OFC organised under Hong Kong law is required to implement appropriate arrangements, as far as reasonably practicable, for the purpose of complying with applicable regulatory requirements, which include at least one investment manager that is licensed or registered for Type 9 (asset management) regulated activity. The investment manager of an OFC must (at all times) be and remain 'fit and proper' to act in the capacity of an investment manager at and after the time of registration of the OFC. 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.

Further, in conducting the investment management functions of the OFC, the investment manager should comply with the FMCC; the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ; the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC ; 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 Authorised Institutions) , as if all of 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 SFC.

Pursuant to section 112T of the SFO, every officer of an OFC (including a director or investment manager) is liable for any 'misconduct', which is broadly defined to include negligence, default, breach of duty or breach of trust on the part of a director or an investment manager while performing their duties. Further, pursuant to sections 112ZC and 112ZD of the SFO, any contractual provision that seeks to exempt or indemnify any officer of an OFC (including directors and investment managers) from any liability arising from the officer's misconduct is void. Accordingly, any limitation of liability clause that contravenes these requirements is not enforceable, except in circumstances where the Hong Kong courts are satisfied that the officer has acted honestly and had reasonable excuse for the misconduct in question.

Law stated - 30 June 2022

Governance and other special issues or requirements

Are there any governance or other special issues or requirements particular to hedge fund vehicles formed in your jurisdiction? Does your jurisdiction impose any environmental, social and governance (ESG) obligations on hedge funds or their managers?

The SFC has published template instruments of incorporation (IOI) for public and private OFCs organised under Hong Kong Law, which set forth the baseline corporate governance requirements that are generally expected of an OFC. OFCs are free to include other provisions in their individual IOIs and make relevant variations as appropriate, provided that any such addition or variation does not result in the breach of any OFC-related law or regulation. For example, at a minimum the IOIs must contain the provisions mandated under section 112K of the SFO including, but not limited to, a provision as to the kinds of property in which the OFC will invest. Where the OFC invests 10 per cent or more of the gross asset value of the OFC in non-financial or other less common asset classes, the offering document must contain clear disclosure of all material risks that are specific to the type and nature of the assets in which the OFC invests. In the case of a public OFC, the requirements in the SFC Products Handbook must also be observed.

In addition, the following changes to an OFC require the special approval of the SFC:

- appointment of a director, custodian or investment manager;
- change of name of an OFC or sub-fund of an OFC;
- establishment of a new sub-fund under an OFC; and
- termination of an OFC or a sub-fund and the cancellation of registration of an OFC.

For open-ended OFCs, there are no specific restrictions on redemption pursuant to section 13.2(c) of the OFC Code. For closed-ended OFCs, there are no restrictions that preclude an OFC from imposing redemption terms and conditions, subject to clear disclosure, pursuant to section 13.3 of the OFC Code. There are also no applicable regulatory restrictions in relation to the right of participants to transfer their interests to third parties.

In August 2021, the SFC issued a circular that applies to Type 9 (asset management) licensed persons, including their representatives, whose business involves the management of collective investment schemes (whether authorised or unauthorised) or discretionary accounts (in the form of an investment mandate or pre-defined model portfolio) (fund managers) relating to the management of climate risks in their funds. These fund managers are required to take climate-related risks into consideration in their governance, investment and risk management processes and include appropriate disclosure, as relevant. The circular sets forth the expected standards for compliance with the FMCC in this regard.

These include (1) baseline requirements that apply to all fund managers managing funds; and (2) enhanced standards that apply only to fund managers with aggregate fund assets under management (excluding assets under discretionary account management) of HK$8 billion or more for any three-month period during the previous reporting year (large fund managers).

Apart from the size of the fund manager of an OFC, the extent to which these requirements apply to the fund manager will depend on its role and the relevance and materiality of climate-related risks to the investment strategy and funds under management.

Large fund managers will need to comply with the baseline requirements by 20 August 2022 and enhanced standards by 20 November 2022 (except for the requirement to disclose the portfolio carbon footprint, if applicable). All other fund managers will need to comply with the baseline requirements by 20 November 2022.

The key baseline requirements, which apply to all SFC Type 9 (asset management) licensed fund managers, include:

- ensuring board and management-level oversight of climate-related issues;
- identifying climate-related risks that are relevant and material to the investment strategy and taking reasonable steps to assess the impact of these risks on the performance of any underlying investments;
- considering climate-related risks in risk management procedures; and
- disclosing (eg, on the company website) how climate-related risks are managed by the board and management functions.

The key enhanced standard requirements, which apply only to large fund managers, include:

- assessing the relevance and utility of scenario analysis in evaluating the resilience of investment strategy to climate-related risks;
- taking reasonable steps to identify the portfolio carbon footprint of the Scope 1 and Scope 2 greenhouse gas emissions associated with the funds' underlying investments; and
- disclosing how the engagement policy is implemented and providing data on the portfolio carbon footprint associated with the fund's underlying investments.

Law stated - 30 June 2022

Fund sponsor insolvency or change of control

With respect to institutional sponsors of hedge funds organised in your jurisdiction, what are some of the primary legal and regulatory consequences and other key issues for the hedge fund and its general partner and investment adviser arising out of a bankruptcy, insolvency, change of control, restructuring or similar transaction of the hedge fund's sponsor?

There is no specific statutory requirement that stipulates that the insolvency of an institutional sponsor will have a direct impact on a hedge fund organised under Hong Kong's OFC regime or the investment manager. The institutional sponsor and the investment manager are separate legal entities. However, contractually speaking, there could be relevant provisions in the OFC's governing documents that determine the consequences in the event of the bankruptcy, insolvency, change of control, restructuring or any similar transaction affecting the institutional sponsor, and thereby triggering a change of the investment manager (eg, if the institutional sponsor and investment manager are affiliated parties).

In the context of an OFC, where there is a change of control, such as in the case of the removal or retirement of the investment manager, a termination notice should be issued to the SFC to formalise the replacement. Pursuant to section 6.4 of the OFC Code, the OFC must have in place appropriate arrangements to ensure that at least one investment manager of the OFC is licensed or registered with a Type 9 licence. A mere insolvency of the fund will not necessarily lead to the revocation of a SFC licence. However, if the SFC determines that a regulated person's conduct suggests it is guilty of misconduct or is not 'fit and proper' to remain licensed, and that the nature and seriousness of the conduct warrants disciplinary action (eg, where the conduct impacts market integrity or gives rise to pecuniary damages to a client), the SFC could impose penalties on the licensed corporation, which may include the revocation of any licence held.

Law stated - 30 June 2022

REGULATION, LICENSING AND REGISTRATION

Principal legislation and regulatory bodies

What principal legislation governs hedge funds in your jurisdiction? Which regulatory bodies have authority over a hedge fund and its manager in your jurisdiction, and what are their audit and inspection rights?

The principal legislation governing hedge funds formed in Hong Kong (ie, open-ended fund companies (OFCs)) is the Securities and Futures Ordinance (Cap 571) (SFO), the Securities and Futures (Open-ended Fund Companies) Rules

(Cap 571AQ) and the related codes of conduct published by the Securities and Futures Commission (SFC) including the Code on Open-ended Fund Companies and, for the publicly offered OFCs, the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products .

The SFC is the statutory regulator for OFCs and licensed managers holding a Type 9 (asset management) licence. A one-stop approach is adopted for the establishment, registration and authorisation of a public or private OFC. The applicant is only required to submit the relevant application documents and the prescribed fees to the SFC. No separate submission of documents and fees to the Companies Registry is required.

Once registered, the SFC is entitled to conduct both an on-site review and off-site audit of a licensed manager. There are four types of applicable on-site audit: a routine inspection; a special inspection; a thematic inspection; and a prudential visit. Upon request, the investment manager may need to provide the SFC with appropriate information on a periodic and an ad hoc basis to facilitate the effective monitoring of systemic risks.

Law stated - 30 June 2022

Reporting and disclosure requirements

What key reporting and disclosure requirements apply to hedge funds in your jurisdiction?

The key reporting requirements that are applicable to OFCs established in Hong Kong include:

- annual (or, if applicable, interim) audited financial statements;
- the provision of offering documents;
- the provision of any alteration of the instrument of incorporation;
- a statement of circumstances issued by auditor or custodian on their cessation of office to indicate circumstances that should be brought to the attention of shareholders or creditors; and
- certain changes of key operators (including, the directors or investment manager).

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 covered. All financial reports must be filed with the SFC within the same time frame.

The annual financial reports of the OFC are expected to contain information regarding the investment portfolio, assets, liabilities, income and expenses of the OFC to enable shareholders to make an informed judgement regarding the operation, key developments and performance of the OFC. Specifically, the annual report must disclose the items required for observance of the applicable accounting standards and include (without limitation) the following:

- the total value of investments, bank balances, dividends and other receivables as at the end of the financial period;
- the income generated or earned by the OFC during the financial period, including any investment income, interest income or dividend income;
- the expenses borne by the OFC, including the fees paid to the directors, investment manager, and the custodian during the financial period;
- the number of shares in issue, and the net asset value per share, at the beginning and end of the financial period, respectively;
- the details of any distribution declared or paid during the financial period should be set forth in the notes to the accounts; and
- information concerning any cross sub-fund investments that are conducted during the financial period.

Public OFCs are subject to additional requirements. For example, they are required to obtain the pre-approval of the SFC for changes to the constitutive documents, material changes in the investment objectives, policies and restrictions of the scheme, material changes in dealing arrangements, pricing arrangements or the distribution policy of the scheme and any other changes that may have a material adverse impact on a shareholder's rights or interests.

Investment managers must ensure that all information furnished to the SFC is in all material respects complete and not misleading. If a manager becomes aware that the information provided does not meet this requirement, the manager is expected to inform the SFC promptly.

There is no specific requirement to notify the SFC of the identity of the investors and of any change in the ownership or control of an OFC.

The key disclosure requirements to investors include whether the OFC is a private or public OFC; the nature of an OFC (ie, with variable capital and limited liability); the circumstances for the cessation of key operators and the attendant removal procedures; the custody arrangements for the OFC's property and the associated material risks; a summary of the circumstances for termination; any party that may apply for termination and any shareholders' approval required for termination; the manner in which shareholders may obtain key information and make enquiries; and, for an OFC with sub-funds, a statement regarding the segregated liability between sub-funds and a warning statement regarding the enforceability of such segregation in foreign courts.

In addition, private OFCs must disclose the investment scope, investment restrictions and all material risks that are specific to the type and nature of the assets in which the OFC invests, in particular, where the OFC invests 10 per cent or more of the gross asset value of the OFC in non-financial or other less common asset classes. Public OFCs are subject to additional requirements, for example, disclosure of their collateral policy and criteria, the characteristics of the units and shares, the distribution policy, fees and charges payable by investors and material taxation provisions.

Disclosures must be clear, concise and effective, containing the information necessary for investors to be able to make an informed judgement in relation to an investment in the OFC and to be kept up to date. Where ongoing disclosure is required, information must be disseminated in a timely and efficient manner.

Law stated - 30 June 2022

Fund licensing and registration

What regulatory approval, licensing or registration requirements apply to hedge funds in your jurisdiction? Does it make a difference whether there are significant investment activities in your jurisdiction?

The majority of the hedge funds that are managed from Hong Kong are organised in the Cayman Islands. Hedge funds that are domiciled in Hong Kong are typically organised as OFCs. An OFC, whether private or public, is required to register with the SFC. The domicile of the hedge fund vehicle can be impacted by whether significant investment activity occurs in Hong Kong since this can affect the taxation base of the fund.

Law stated - 30 June 2022

Fund manager registration

Is a hedge fund's manager – or any of its officers, directors or control persons – required to register as an investment adviser in your jurisdiction?

A hedge fund's investment manager is required to obtain a Type 9 (asset management) licence from the SFC to carry out asset management regulated activities. If it intends to carry out Type 1 (dealing in securities), Type 2 (dealing in futures contracts), Type 4 (advising on securities) or Type 5 (advising on futures contracts) regulated activities, it need not be licensed separately for these categories of regulated activity, provided that such activities are carried out solely for the primary purpose of operating the asset management business.

If a hedge fund's investment manager is licensed for Type 9 regulated activities, every employee or representative that performs functions on behalf of the investment manager in relation to any regulated activities (other than certain back and middle office functions performed by accountants, clerks or cashiers) is required to be licensed by the SFC as a 'responsible officer' or 'licensed representative' of the investment manager to conduct Type 9 regulated activities.

In addition, an investment manager must have at least two responsible officers at all times to supervise the Type 9 regulated activities conducted by the manager. Every executive director of the manager (ie, a director who actively participates in or is responsible for directly supervising the business of any regulated activity) must be approved by the SFC as a responsible officer. In addition, the managers in charge (MIC) who are appointed by the investment manager to direct the Overall Management Oversight function and the Key Business Line function (as defined by the SFC) are required to be licensed as responsible officers.

The SFC's approval will be required for an individual or entity to qualify as a 'substantial shareholder' of the regulated investment manager by virtue of its shareholding or voting power.

Law stated - 30 June 2022

Fund manager qualifications and other requirements

Does your jurisdiction impose any specific qualifications or other requirements on a hedge fund's manager or any of its officers, directors or control persons?

A hedge fund investment manager that seeks Type 9 regulated status must:

- be 'fit and proper' to be licensed – the SFC will have regard to all applicable circumstances, including but not limited to the investment manager's financial status and solvency; its ability to carry on the regulated activities competently, honestly and fairly; its reputation, character, reliability and financial integrity; the educational and professional qualifications and industry experience of its key personnel; the investment manager's organisational structure; and the combined competence of its personnel;
- be able, if licensed, to comply with the financial resource requirements, including the requirement to maintain at all times paid-up share capital of not less than HK$5 million and liquid capital of not less than HK$3 million; if an investment manager is granted a Type 9 licence subject to the licensing condition that it shall not hold client assets, the minimum paid-up share capital requirement does not apply and the liquid capital requirement is reduced to HK$100,000 (however, in practice, the SFC generally requires that an additional 'buffer' of 20 per cent be maintained over and above the minimum liquid capital requirement at all times that licenses are held);
- be insured in accordance with rules (if applicable) as prescribed by the SFO;
- have appointed MIC and submitted the prescribed MIC information and associated organisational charts to the SFC; and
- have identified and lodged applications with the SFC for approval of its responsible officers who will be charged with responsibility for supervising its regulated activities.

An individual applying to become a responsible officer or licensed representative for Type 9 (asset management) regulated activities must demonstrate sufficient competence and experience to satisfy the SFC that he or she:

- has the necessary academic, professional or industry qualifications; in general, if an individual has obtained a degree in the designated fields of accounting, business administration, economics or finance and law or passed at least two courses in these designated fields or obtained certain professional qualifications, he or she can be exempted from undertaking the proficiency examinations required to satisfy the recognised industry qualification (RIQ) requirements or attend continuous professional training (CPT) courses;
- is knowledgeable about the financial products and markets that are relevant to the investment manager's investment strategy;
- must have sufficient relevant industry experience – a degree holder that is applying to become a responsible officer is required to demonstrate at least three years of relevant industry experience obtained during the previous six years prior to submission of the application; a licensed representative must demonstrate a degree in the designated fields, have passed at least two courses in the designated fields or have obtained certain professional qualifications (however, if the applicant holds a degree that does not fall within the designated fields and has not passed at least two courses in the designated fields, the candidate must demonstrate at least two years of relevant industry experience during the previous five years prior to submission of the application, have obtained the relevant RIQ or completed extra CPT;
- must demonstrate at least two years of management experience if applying to become a responsible officer;
- has a good understanding of the regulatory framework, including the laws, regulations and associated codes governing the intended industry sectors of focus – the individual is required to pass the relevant local regulatory framework paper examinations; and
- is familiar with the ethical standards expected of a financial practitioner.

Law stated - 30 June 2022

Political contributions

Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure of, political contributions by a hedge fund's manager or investment adviser or their employees?

There are no specific 'pay to play' rules or policies in Hong Kong that restrict, or require disclosure of, political contributions by a hedge fund's investment manager, investment adviser or their employees. However, fund managers are required to comply with applicable laws that include the Prevention of Bribery Ordinance (Cap 201) (POBO), which is the primary anti-corruption legislation that prohibits the offer and receipt of bribes in both the public and private sectors and establishes a series of offences for corrupt conduct. It is an offence under the POBO to offer any bribe to a public servant (or, as a public servant, to solicit or accept an advantage) as an inducement or reward in connection with their capacity as a public servant or to influence any business transaction with a public body, whether in Hong Kong or elsewhere. Although the POBO does not expressly prohibit bribery of a foreign public official, where such an official that is residing outside Hong Kong is bribed in exchange for a favour relating to the performance of the foreign official's duties outside Hong Kong, the POBO will continue to apply where the bribe is offered in Hong Kong (even if paid to the public official outside of Hong Kong).

In addition, fund managers must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to identify, prevent, manage and monitor any actual or potential conflict of interest, including conducting all transactions in good faith, at arm's length and in the best interests of the fund on customary commercial terms. Where an actual or potential conflict arises, the conflict should be managed and minimised by appropriate safeguards and measures to ensure the fair treatment of fund investors. Any material interest or conflict should be properly disclosed to the fund's investors.

Law stated - 30 June 2022

Use of intermediaries and lobbyist registration

Are there any rules – or policies of public pension plans or other governmental entities – in your jurisdiction that restrict, or require disclosure by a hedge fund's manager or investment adviser of, the engagement of placement agents, lobbyists or other intermediaries in the marketing of the fund to public pension plans and other governmental entities? Are there any rules that require a fund's investment adviser or its employees and agents to register as lobbyists in the marketing of the fund to public pension plans and governmental entities?

There are no specific rules or policies in Hong Kong that restrict or require specific disclosure by a hedge fund's investment manager or investment adviser of the engagement of a placement agent, lobbyist or other intermediary in the marketing of the fund to a public pension plan or other governmental entity. The marketing of interests in a fund in Hong Kong is a regulated activity that typically triggers a Type 1 licensing requirement, subject to the availability of an applicable exemption.

Law stated - 30 June 2022

Anti-money laundering regulations

What anti-money laundering rules and requirements apply to hedge funds in your jurisdiction?

In conducting the investment management function of an OFC organised under Hong Kong law, the investment manager must comply with (among others) the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) (the AML Guidelines) and the Prevention of Money Laundering and Terrorist Financing Guideline issued by the SFC for Associated Entities , 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 SFC. These provisions regulate the investment manager's conduct of requisite checks in respect of anti-money laundering, customer due diligence, the oversight of ongoing obligations and applicable reporting and record-keeping obligations.

Similarly, in performing its duties of safekeeping, the scheme property of a private OFC or a private

OFC custodian that is licensed by or registered with the SFC to conduct a regulated activity must comply with the applicable provisions of the AML Guidelines as if:

- 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 SFC; and
- any reference to client assets, including client money, client securities and securities collateral in the applicable codes and guidelines, includes the private OFC's scheme property.

At a minimum, an investment manager or a custodian should:

- appoint a director or senior manager as a compliance officer (CO) that has overall responsibility for the establishment and maintenance of the regulated firm's anti-money laundering (AML) and counter-financing of terrorism (CFT) systems; and
- appoint a senior member of staff as the money laundering reporting officer (MLRO) who is the central reference point for suspicious transaction reporting.

The functions of the CO and MLRO may be performed by the same person. In addition, the senior management of the investment manager or the custodian should ensure that the CO and the MLRO are:

- appropriately qualified with sufficient AML/CFT knowledge;
- independent of all operational and business functions;
- ordinarily resident in Hong Kong;
- fully conversant with the applicable statutory and regulatory requirements and money laundering and terrorist financing risks arising from the business; and
- have sufficient resources, including adequate staff with appropriate coverage for any absence of the CO or MLRO (ie, an alternate or deputy CO or MLRO should exist)

Upon registration with the SFC, an OFC is required to disclose the name (and any other particulars required by the SFC) of each person that is to be:

- a director of the OFC (if incorporated);
- an investment manager of the OFC (if incorporated); or
- a custodian of the OFC (if incorporated).

There is no requirement for disclosure of the identity (or other particulars) of the investors in an OFC upon registration. However, the OFC must at all times keep and maintain a register of shareholders that identifies (within two months after the date of issue of any shares in the OFC):

- the names and addresses of its shareholders;
- the date on which each person is entered in the register as a shareholder;
- the date on which any person ceases to be a shareholder; and
- the shares held by each shareholder, including the amount paid or agreed to be considered as paid.

Law stated - 30 June 2022

Data security and privacy regulations

What data security or privacy rules and regulations apply in your jurisdiction regarding the protection and handling of private data about a hedge fund or its investors?

The principal governing legislation is the Personal Data (Privacy) Ordinance (Cap 486) (PDPO). The SFC also issues circulars from time to time to provide guidance in relation to data security and data privacy, in particular regarding the use of electronic data storage and cybersecurity risks. Importantly, the PDPO requires all data users to, on or before collection of personal data, explicitly inform a data subject of his or her rights to request access to, and the correction of, his or her personal data and the name (or job title) and address of the person to whom such requests should be made. As a matter of best practice, it is customary for fund managers to designate a specific person to handle such requests, along with a generic email address as a means of contacting the person to whom data access or correction requests should be made or for the purpose of managing any personal data breach, including any attendant internal or external reporting requirements.

Law stated - 30 June 2022

TAXATION

Hedge fund structuring

What tax considerations are relevant to the form of organisation and initial structuring of a hedge fund in your jurisdiction?

The Inland Revenue Ordinance (Cap 112) (IRO) of Hong Kong imposes tax on property rental income, employment income and business profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong. As a general rule, hedge funds that are organised under the open-ended fund company (OFC) regime would neither derive rental income from land or buildings in Hong Kong nor generate any employment income. Accordingly, any hedge fund exposure to Hong Kong tax under the IRO would generally be in connection with business profits generated by the fund (profits tax).

Aside from profits tax, Hong Kong does not tax the gain on any sale of capital assets (although it can be difficult to substantiate a non-taxable capital gain claim). For example, taxable profits in this context include profits arising from the disposal of both listed securities effected through the Hong Kong Stock Exchange , and from unlisted securities where the purchase or sale contracts are effected in Hong Kong. That consideration aside, Hong Kong does not apply a withholding tax on interest or dividends and does not consider dividend income taxable for purposes of the Hong Kong profits tax regime.

Historically, because of the broad applicability of the Hong Kong profits tax regime, funds managed in Hong Kong were typically established offshore to secure more favourable tax treatment. However, a unified profits tax exemption for all privately offered funds became operative in Hong Kong on 1 April 2019, pursuant to the amendments to the IRO established by the Inland Revenue (Profits Tax Exemption For Funds) (Amendment) Ordinance 2019 . After this significant update, an exemption from profits tax was made available to private funds organised under the OFC regardless of their size and capital structure and covering a significantly broader range of qualifying transactions. For example, as compared to a private fund established in the Cayman Islands, a hedge fund organised under the OFC regime is likely to benefit from a tax exemption with respect to a wider range of asset classes and transaction types.

Notwithstanding the 2019 reforms, a number of residual tax issues remain in the context of private OFCs. For example, if a fund established under the OFC regime acquires or disposes of any ‘Hong Kong stock’ (as defined under the Hong Kong Stamp Duty Ordinance), stamp duty will be imposed at the current rate of 0.13 per cent on the stated consideration or fair market value, whichever is higher. The transferor and transferee will each be liable for the Hong Kong stamp duty upon such transfer (ie, 0.26 per cent in total). There will also be a fixed duty of HK$5 on the instrument of transfer, if any. Similarly, although beyond the scope of the discussion here, individual investors based in Hong Kong may be exposed to a range of local tax consequences, including the imposition of profits tax, as a result of their investment in an OFC (even if the fund itself enjoys a profits tax exemption).

Law stated - 30 June 2022

General tax liabilities and available exemptions

Is a hedge fund vehicle formed in your jurisdiction subject to taxation there with respect to its income or gains? Is the fund required to withhold taxes with respect to distributions to investors? Under what conditions may a hedge fund qualify for applicable tax exemptions?

Capital gains are not generally taxable in Hong Kong (although substantiating such a claim may prove difficult in practice). However, the IRO imposes taxes on property rental income, employment income and business profits. While hedge fund vehicles do not typically generate rental or employment income, they were (at one time) exposed to a

profits tax related to business profits generated by the fund in Hong Kong. This issue has since been addressed by changes to the IRO implemented by the Inland Revenue (Profits Tax Exemption For Funds) (Amendment) Ordinance 2019, which created a broad exemption from the profits tax regime for hedge fund vehicles that meet the following conditions:

- the fund vehicle falls within the definition of 'fund' set forth in section 20AM of the IRO;
- the otherwise assessable profits of the fund are derived from 'qualifying transactions' or 'incidental transactions' as defined in the IRO; and
- the 'qualifying transactions' have been carried out in Hong Kong by or through, or arranged in Hong Kong by, a 'specified person' (ie, an authorised institution registered under the Securities and Futures Ordinance (Cap 571) (SFO) or a corporation holding any licences issued by the Securities and Futures Commission (SFC) under Part V of the SFO); or
- the fund vehicle is a 'qualified investment fund' (as defined in the IRO).

There are, however, two exceptions to the generally available profits tax exemption for private funds organised under Hong Kong's OFC regime. First, although an OFC is generally accepted by the Inland Revenue Department as a profits tax exempt vehicle under the IRO, the following transactions are not exempt:

- profits derived from carrying on a direct trading or direct business undertaking in Hong Kong for a non-Schedule 16C class; and
- income from the holding of assets that are non-Schedule 16C class.

Second, an ordinarily profits tax exempt OFC will not be exempt from profits tax imposed on transactions that 'relate to assets which are typically purchased and sold in the normal course of business of a commercial or industrial enterprise'. As further described in section 20AM(7) of the IRO, these transactions include the purchase, sale or exchange of goods or commodities, the supply of services, the production of goods and the construction of immovable property. In light of the typical investment activities undertaken by a hedge fund, there is relatively little risk of profits tax exposure based on these exceptions, but it is important to bear in mind that funds are not entirely immune to the application of the profits tax regime in Hong Kong depending on the specific nature of their activities.

With respect to distributions to investors, Hong Kong law does not ordinarily require any tax withholding on the part of the fund. However, as with all tax issues, a variety of facts and circumstances, including the nature of the underlying investments being made by the fund, could impact the nature of the applicable tax analysis. Fund sponsors, asset managers and investors should consult their own professional advisers regarding the possible tax consequences of launching a fund under the OFC regime or subscribing for, buying, holding, transferring, selling, redeeming or otherwise disposing of the shares of a Hong Kong domiciled fund, in the context of their own particular circumstances.

Law stated - 30 June 2022

Local taxation of non-resident investors

Are non-resident investors in a hedge fund subject to taxation or return-filing requirements in your jurisdiction?

Generally, no. However, as with all tax issues, a variety of facts and circumstances, including the nature of the underlying investments being made by the fund, could impact the applicable tax analysis.

Law stated - 30 June 2022

Local tax authority ruling

Is it necessary or desirable to obtain a ruling from local tax authorities with respect to the tax treatment of a hedge fund vehicle formed in your jurisdiction? Are there any special tax rules relating to investors that are residents of your jurisdiction?

Generally, it is not necessary to obtain a ruling from local tax authorities with respect to the tax treatment of a private fund vehicle formed under Hong Kong's OFC regime. However, depending on the complexity and nature of applicable tax considerations, it may be desirable to obtain such a ruling. As with all tax issues, a variety of facts and circumstances, including the nature of underlying investments being made by the fund, could significantly impact the applicable analysis.

With respect to special tax rules applicable to local investors, typically any gains arising from the disposal of an interest in an OFC will constitute a non-taxable capital gain for Hong Kong residents. However, the application of Hong Kong tax law is highly fact-specific and, in some circumstances, the nature of the business carried on by the relevant local investor (eg, dealers in securities, financial institutions, insurance companies), may subject any gains to profits tax as an ordinary business profit.

In addition, although distributions by the OFC to investors should generally not be subject to Hong Kong profits tax (whether by way of withholding or otherwise), the IRO contains certain anti-avoidance and 'round-tripping' provisions, which may result in a determination that a Hong Kong resident investor has derived assessable profits from an OFC, notwithstanding that the OFC is itself tax exempt under the IRO and despite no distribution having been made by the OFC. Should such a deeming provision apply, the Hong Kong resident investor would be subject to Hong Kong profits tax on a deemed basis in respect of the applicable share of the tax-exempt profits in the OFC.

Law stated - 30 June 2022

Organisational taxes

Must any significant organisational taxes be paid with respect to hedge funds organised in your jurisdiction?

There are no significant organisational taxes to be paid with respect to funds organised under the OFC regime in Hong Kong. However, among other things, a fee of at least HK$5,000 is required to be submitted in connection with an application to register an OFC with the SFC. Similarly, a fee of HK$3,034 is required for the incorporation of an OFC in Hong Kong, and, for business registration purposes, a minimum of HK$250 is required to be submitted along with the requisite application for a one-year business registration certificate.

Law stated - 30 June 2022

Special tax considerations for sponsors

What special tax considerations are relevant with respect to a hedge fund's sponsor?

Historically, Hong Kong-managed hedge funds employed a two-tiered management structure using an offshore and a Hong Kong-based management vehicle. The offshore manager would typically receive management and performance fees from the fund and would pay the costs of the Hong Kong manager plus an agreed mark-up. In this manner, the Hong Kong manager could shelter a significant portion of its fees from exposure to Hong Kong profits tax. However, the global introduction of legislation, including the International Tax Co-operation (Economic Substance) Law in the

Cayman Islands, tying the allocation of tax liability to the place where economic activity takes place, has significantly decreased the tax efficiency of the two-tiered management structure. In keeping with this global trend, in July 2018, Hong Kong adopted the Inland Revenue (Amendment) No. 6 Ordinance, which provided the Inland Revenue Department with additional powers to impute tax obligations to Hong Kong managers consistent with a manager's specific activities and role within the broader fund structure. This legislation has significantly reduced the viability of the two-tiered management structure in Hong Kong. Accordingly, managers operating in Hong Kong have increasingly opted into a single-tier structure in which the Hong Kong manager directly receives management and performance fees from the fund (subject to Hong Kong profits tax on the amounts received).

To the extent that an investment manager has its operations in Hong Kong, local staff will likely be subject to Hong Kong salaries tax with respect to their salaries and benefits. In the private fund arena more generally, Hong Kong has significantly liberalised the tax regime governing carried interest distributions to investment managers and their employees as set forth in the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance adopted in May 2021.

Law stated - 30 June 2022

Tax treaties

Are there any relevant tax treaties to which your jurisdiction is a party? How do such treaties apply to hedge fund vehicles?

As at April 2022, Hong Kong has signed comprehensive avoidance of double taxation agreements with 45 jurisdictions, including China, the United Kingdom and Canada. Hong Kong is also currently negotiating such treaties with 14 additional jurisdictions, including Norway, Germany and Turkey. Notably, Hong Kong has not signed a tax treaty with the United States and is not presently engaged in negotiations with the United States to sign such a treaty.

Law stated - 30 June 2022

Other significant tax issues

Are there any other significant tax issues relating to hedge funds organised in your jurisdiction?

No.

Law stated - 30 June 2022

OFFERING, SELLING AND TRADING RESTRICTIONS

Marketing restrictions

What principal legal and regulatory restrictions apply to offers and sales of interests in hedge funds formed in your jurisdiction, including the types of investors to whom such funds may be offered without registration under applicable securities laws?

A very tight regulatory net has been cast over the marketing of interests in private funds to Hong Kong investors, and addressing related issues often requires detailed analysis. Broadly speaking, however, unless a hedge fund is authorised by the Securities and Futures Commission (SFC) for sale to the public, the following two sets of rules require consideration.

Product offering rules

Generally, a number of restrictions on making offers or invitations to the public apply under Hong Kong law (including certain disclosure requirements). To avoid these restrictions, promoters commonly seek to rely on the 'private placement' exemption when marketing interests in Hong Kong. Namely, private funds (which are structured as corporations, as opposed to limited partnerships) that offer interests exclusively to 'professional investors', an unlimited number of non-professional investors who invest at least HK$500,000, or no more than 50 offerees in Hong Kong (with no investment minimum) in any 12-month period are exempted from the security offering restrictions. The term 'professional investor' generally encompasses SFC-licensed intermediaries, authorised financial institutions, central banks, insurance companies, pension funds and certain qualified high net worth individuals, as defined in the Securities and Futures (Professional Investor) Rules .

Licensing rules

The act of marketing interests in an investment fund (even when conducted via private placement) is regarded as a regulated activity under Hong Kong law and requires a Type 1 (dealing in securities) licence, unless an exemption applies. Most commonly, unlicensed promotors rely on the 'as principal' exemption. This exemption is very limited and narrowly constructed. It only applies to a person dealing 'as principal' (typically, a director of the fund) with a limited category of 'professional investors'. Most notably, the exemption does not apply to high net worth (HNW) individuals. It is, therefore, much narrower than the broader private placement exemption discussed above. In practice, when marketing to non-professional investors or HNW individuals, a promoter will need to appoint a locally licensed intermediary or placement agent to promote the fund.

Law stated - 30 June 2022

Investor restrictions

Are there any restrictions on the types and number of investors that may participate in hedge funds formed in your jurisdiction (other than those imposed by applicable securities laws)?

There is no statutory limitation on the number of investors that may participate in a hedge fund. Investment funds that are open to public participation require the prior authorisation of the SFC and will be subject to additional requirements that are applicable under the SFC's Code on Unit Trusts and Mutual Funds . Funds that are privately placed should strictly limit their offering to professional investors only, comply with the minimum investment requirement (namely, HK $500,000) if offered to non-professional investors or limit the number of offerees to no more than 50 people during any 12-month period.

Law stated - 30 June 2022

Bank participation

Are there any legal or regulatory restrictions that specifically affect banks with respect to investing in or sponsoring hedge funds?

There is no Hong Kong law or regulation that restricts banks from investing in or sponsoring hedge funds that are managed in Hong Kong. In practice, when marketing to non-professional investors or HNW individuals, a promoter will need to appoint a locally licensed intermediary or placement agent to promote the fund. However, in this context, there is no chaperoning exemption that is available under Hong Kong law. This means that attending a sales meeting with a licensed person from a bank that is acting as the placement agent will not cure a breach by an unlicensed

representative of the investment manager.

Law stated - 30 June 2022

Trading activities

Are there any regulatory restrictions or disclosure obligations with respect to a hedge fund's trading activities?

There are a broad range of regulatory restrictions and disclosure obligations that apply to a hedge fund's trading activities in Hong Kong. This can create additional complexity and impose burdensome compliance obligations on hedge fund investment managers that hold large investment positions.

Generally, the disclosure of interests regime in Hong Kong applies to investors holding 5 per cent or more of any class of voting shares in listed securities or their derivatives (ie, 'substantial filers'). There is no duty to report positions below 5 per cent, but a person that holds 5 per cent or more in listed securities is typically deemed to be a 'substantial shareholder' and must report their interest. The netting off of long and short positions in this context is not permitted.

The threshold applies to all interests in the securities whether held directly (long positions) or indirectly (via equity derivatives or swaps regardless of whether they are physically settled, by delivery of the underlying shares, or cash settled). This means that equity swaps in the underlying shares must be added to a fund's long positions to determine whether it crosses the relevant thresholds.

Discretionary investment fund managers must aggregate holdings across all funds under management (and must separately consider whether a report is to be made on a fund-by-fund basis), any proprietary interests and any interests of the client discretionary accounts under management. In such circumstances, each fund or account holder (as well as the investment manager itself) may be also subject to a separate disclosure obligation if the relevant threshold is exceeded.

Timing

Notifications must generally be filed within three business days via an online portal called DION.

Trading of virtual assets

Under current regulations, the trading of 'virtual assets' can only be offered to professional investors in Hong Kong, unless such products qualify as complex exchange-traded derivatives that can be offered to retail investors in a designated jurisdiction and through virtual asset trading platforms licensed by the SFC. Further, hedge fund investment managers are also subject to additional terms and conditions, including disclosure requirements, if they manage or plan to manage portfolios with either a stated investment objective to invest in virtual assets or an intention to invest 10 per cent or more of the gross asset value of the portfolio in virtual asset.

Other significant reporting requirements

Large position reporting for derivatives is widely adopted in all international futures and options exchanges. In Hong Kong, the position limit regime imposes different levels of position limits and large-open position reporting requirements for different futures and options contracts creating further restrictions on trading activities by hedge fund investment managers. Importantly, hedge fund investment managers may not hold or control futures contracts or stock options contracts in excess of the prescribed statutory position limits. Positions above the reporting threshold are

required to be disclosed with the relevant exchanges. Information requested usually includes details about contracts held, beneficial ownership, transaction originators, the nature of positions held and the brokers used.

The SFC has published a detailed Guidance Note on Position Limits and Large Open Position Reporting Requirements . The prescribed limits in the rules apply to all positions held or controlled by any person including positions held by the person for his or her own account and positions belonging to other persons but under the control of such person (the aggregation requirements).

Law stated - 30 June 2022

Side letters

Are hedge funds or their general partners permitted to enter into side letters with investors? Are there any limits on the contents of side letters?

There is no law or regulation that restricts the substance of a side letter. Under the Fund Manager Code of Conduct, however, where a fund manager has granted preferential treatment to certain investors, it should disclose this fact and the material terms in relation to redemption rights in the side letter to all relevant potential and existing fund investors.

Law stated - 30 June 2022

LIQUIDITY TERMS

Redemptions

Are there any regulatory or other limitations on hedge funds' liquidity terms? Are there any limits on lock-up periods, frequency of redemption dates or length of redemption notice? Are withdrawal 'gates' permissible? Are 'side pockets' permitted? Can different liquidity terms be offered within the same hedge fund structure?

A private hedge fund that is organised under Hong Kong's open-ended fund company (OFC) regime is not generally subject to specific limitations on liquidity terms, including the imposition of different liquidity terms on different share classes within the same fund structure or the use of 'side pockets'. The parties are free to contractually establish relevant liquidity terms, including the use of 'side pockets' or different share classes with different characteristics, provided any such limitations are clearly set forth in the fund's offering or incorporation documents. Pursuant to the Securities and Futures Commission's (SFC) Code on Open-Ended Fund Companies (the OFC Code), liquidity restrictions (as with all other operational aspects of a hedge fund organised under the OFC regime) must comply with a number of general principles. Among other things, the organisational documents of the fund must set out the relevant terms of any liquidity restrictions in clear, concise language containing all the information necessary for investors to make an informed judgement regarding the decision to invest in the fund. Any liquidity restrictions must be implemented in a manner consistent with any such disclosure. Moreover, while not operating as a substantive limitation on the liquidity terms that can be offered by Hong Kong OFCs, the Securities and Futures (Open-ended Fund Companies) Rules (Cap 571AQ) require certain operational formalities in terms of maintaining a register of shareholders and recording redemption and transfer requests.

Law stated - 30 June 2022

Suspensions

Are there any legal or regulatory issues associated with a suspension of redemptions, payment of redemption proceeds or net asset value?

Private hedge funds that are organised under Hong Kong's OFC regime are not generally subject to legal or regulatory restrictions on their operations, including with respect to the declaration of a suspension, the payment of redemption proceeds or the calculation of net asset value. However, the fund's offering documents must clearly set out any such applicable terms with sufficient clarity and detail as to afford an investor the opportunity to make a reasonably informed decision regarding whether to invest in the fund. Further, the general principles outlined in the OFC Code apply to redemption-related issues with respect to privately organised Hong Kong OFCs. Accordingly, the organisational documents of the fund must set out the relevant terms of any liquidity restrictions in clear, concise language containing all the information necessary for investors to make an informed judgement regarding the decision to invest in the fund. Additionally, the declaration of a suspension or the processing and payment of redemption requests must be carried out in a manner that is fair to all investors, performed with due skill, care and diligence and must comply with the terms set forth in the fund's offering documents. In this regard, the OFC Code requires the use of a proper and fully disclosed methodology for determining redemption amounts that are payable and similarly requires that any redemption value be established on a forward basis.

When dealing with the declaration of a suspension or any change in redemption policy, careful attention must also be paid to avoid any potential conflicts of interest. The OFC Code mandates that, if a conflict is unavoidable (and investor interests can be sufficiently safeguarded), the conflict must be managed appropriately to minimise its impact on investors (including through appropriate disclosure). The general principles outlined by the OFC Code also require the exercise of good corporate governance by OFC boards who should be aware that any actions undertaken with respect to the declaration of a suspension will likely be closely scrutinised by the SFC and other regulators.

Law stated - 30 June 2022

In-kind distributions

Are there any legal or regulatory limitations or disclosure issues related to a hedge fund's ability to make in-kind distributions to its investors?

There are no specific regulatory limitations on the ability of private hedge funds organised under Hong Kong's OFC regime to make in-kind distributions to investors. However, the terms applicable to any such distribution must be clearly set forth in the fund's offering documents. Further, as with all other aspects of private hedge fund operation under the OFC regime, in-kind distributions are subject to the general principles outlined in the OFC Code. Accordingly, in-kind distributions must be carried out fairly and in full compliance with the fund's offering documents. Moreover, conflicts of interest related to the decision to undertake an in-kind distribution must be avoided to the extent possible and, if such conflicts arise (and investors' interests can be appropriately safeguarded), the fund is obligated to manage any such conflict to minimise the potential impact on investors (including through appropriate disclosure). Significantly, OFC boards are obligated under the OFC Code to maintain principles of good corporate governance and should be aware that the decision to make an in-kind distribution may draw additional scrutiny from the SFC and other regulators regarding the reasons for the distribution and whether investors were adequately informed.

Law stated - 30 June 2022

UPDATE AND TRENDS

Recent trends and developments

What are the most significant recent trends and developments relating to hedge funds in your jurisdiction? What impact do you expect such trends and developments will have on global hedge fundraising and on hedge funds generally?

The most significant trend applicable to hedge funds in Hong Kong has been the continued emphasis on developing a stable and attractive domestic legal platform to encourage the formation (and re-domiciliation) of private hedge funds. To that end, Hong Kong introduced the open-ended fund company (OFC) structure in late 2018, a critical development making available a new legal form for Hong Kong-domiciled funds and aligning operational requirements for Hong Kong-based hedge funds with international standards. Given the relatively short period since the implementation of the OFC regime, the legal principles applicable to OFCs continue to evolve. However, as a number of popular offshore fund jurisdictions impose economic substance requirements and otherwise address tax-related issues such as base erosion and profit shifting, the availability of Hong Kong OFCs increasingly offerfund sponsors a compelling case for 'onshoring' existing funds or launching new funds in the market. This trend is expected to continue in the coming years, especially in light of the significant benefits that Hong Kong offers asset managers and fund sponsors: available investment capital, a highly educated workforce and privileged access to markets in China and other parts of Asia.

In keeping with the domestic focus on attracting fund sponsors and managers to Hong Kong, the Securities and Futures Commission (SFC) has continued to revise the Fund Manager Code of Conduct and related regulatory provisions to align Hong Kong with global best practices in terms of risk management and disclosure requirements. In this regard, the SFC has made a notable effort to focus on environmental, social and governance (ESG) issues with respect to private funds. As ESG and climate-focused funds continue to draw intense interest from the investment community, Hong Kong authorities are keeping pace by developing a cutting-edge regulatory framework to promote a genuine commitment among investment managers to ESG principles. Given this commitment, and other broader developments, we anticipate Hong Kong becoming a focal point for ESG investments in the broader Asian market in the coming years.

Finally, Hong Kong regulators have begun turning their attention to the digital space in a concerted effort to develop a coherent framework to govern investments in virtual assets. In January 2022, the SFC, together with the Hong Kong Monetary Authority, published a joint circular addressing the distribution of virtual assets and the provision of virtual asset-related services. Among other things, the circular outlines new disclosure and investor suitability requirements applicable to Hong Kong licensed intermediaries and authorised institutions that deal in virtual assets. Hong Kong's continuing efforts to develop a stable environment for investment in virtual assets, along with steadily increasing investor interest, suggest that the jurisdiction will remain uniquely well positioned to serve as a launch point for Asian funds seeking to invest in virtual assets (especially in light of broader regulatory headwinds these assets are facing in other Asian markets).

Law stated - 30 June 2022

Jurisdictions

Hong Kong	Sidley Austin LLP
Ireland	Maples Group
Singapore	Sidley Austin LLP
South Korea	Bae, Kim & Lee LLC
United Kingdom	Sidley Austin LLP
USA	Sidley Austin LLP