WEBINAR ON
COLLECTIVE INVESTMENT SCHEMES AND IMPACTS ON THE TRUSTEE INDUSTRY

(7 October 2021)

Trustee
香港信託人公會
Hong Kong Trustees' Association

Latest update on the Hong Kong Open-ended Fund Companies and Limited Partnership Funds regime and other development in the asset management industry

Sandy Fung
Tax Partner
Alternative Investment
KPMG China
sandy.fung@kpmg.com

Agenda

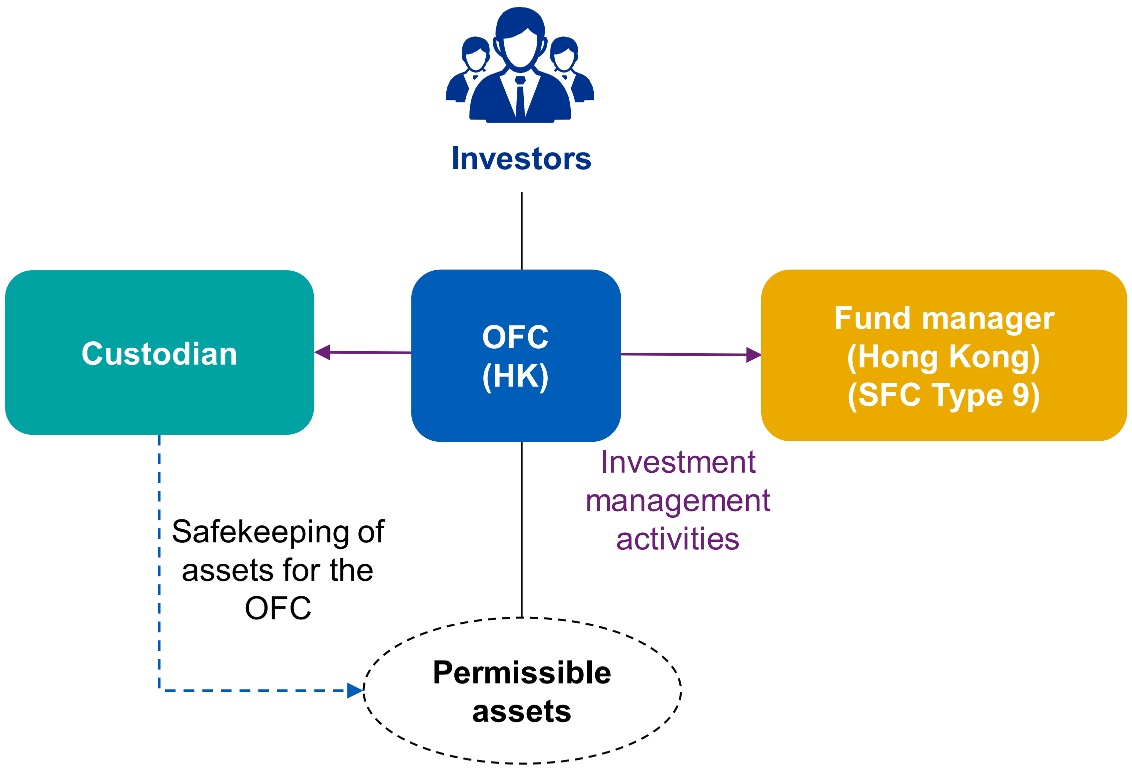
1. Hong Kong Open-ended Fund Company (“OFC”)
2. Hong Kong Limited Partnership Fund (“HKLPF”) regime
3. Funds Exemption
4. Tax concession on Carried Interest
5. Fund Re-domiciliation
6. Q&A

Mainland China – the key growth engine

- The Chinese fund industry surpassed the RMB 20 trillion barrier for the first time in 2020. It is by far the most dynamic market.
- From a global perspective, mainland Chinese equities are bonds would become a growing component for portfolios as the country recovers more rapidly from COVID-19 than other development nations.
- From the Greater Bay Area ("GBA"), with a population of 71 million and a combined GDP of USD1.6 trillion, presents a more specific, wealth-oriented opportunities for asset managers.
- In 2019, 20% of all high-net-worth individuals in China lived in the GBA. With the launch of the GBA Wealth Management Connect Scheme, the residents of the cities in the GBA could invest in eligible investment products distributed by banks in Hong Kong and Macau and vice versa. While the Scheme will start by offering low to medium risk products, with a quota of RMB1 million per individual, we expect that the Scheme to expand overtime and enlarge the overall size of the funds market.

Hong Kong Open-ended Fund Company ("OFC")

OFC - key features

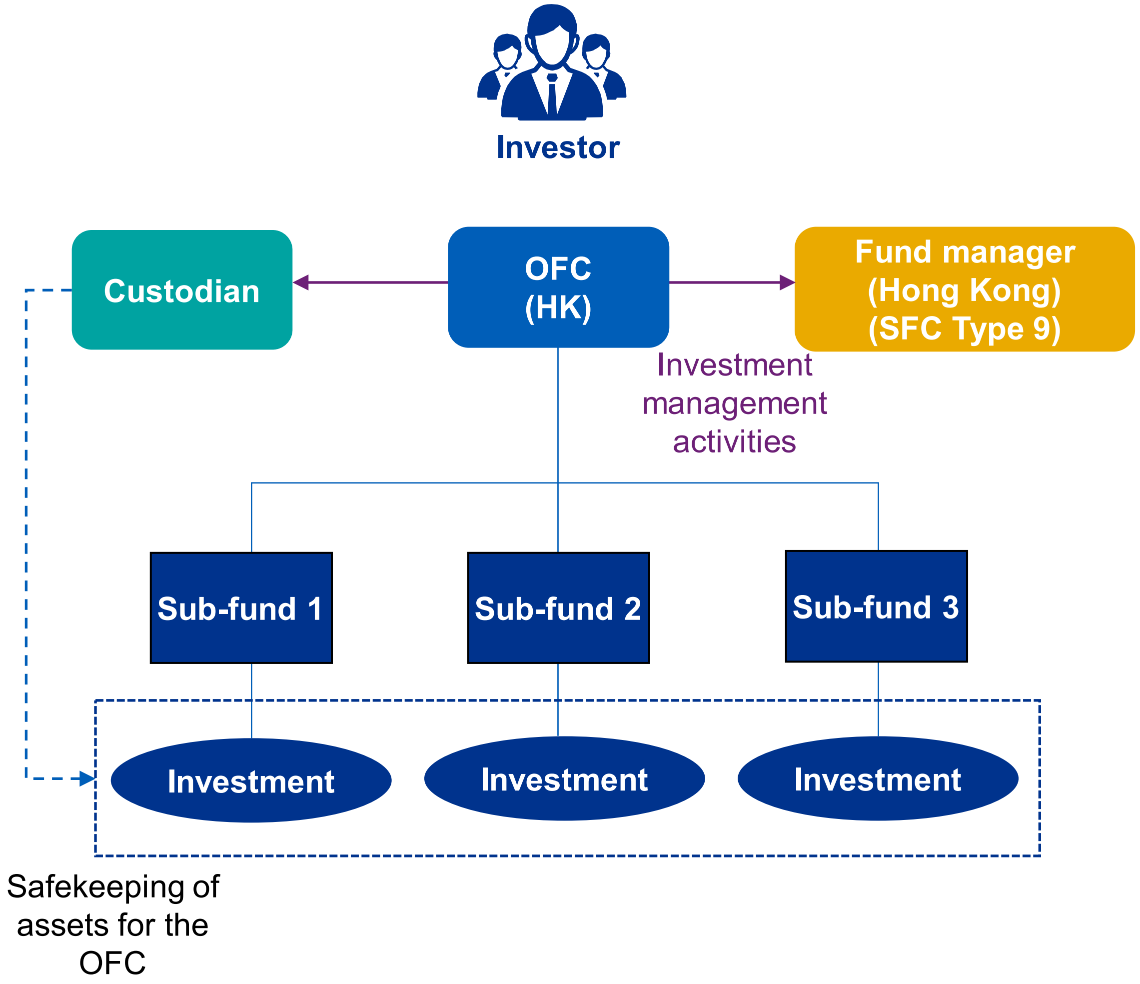


- Introduced in July 2018 to provide a new fund vehicle for Hong Kong fund
- Initially targeted at hedge funds and/or retail funds
- The SFC amended the Code on OFC in September 2020 whereby OFC in Hong Kong is **no longer subject to investment restrictions**
- As of August 2021, there are around 20 OFC set up in Hong Kong

Key features

- Limited liability company with variable share capital structure
- Established by registration with the SFC and incorporated with the Companies Registry
- Governed by the Securities and Futures Ordinance, Securities and Futures (Open-ended Fund Companies) Rules and Code on Open-ended Fund Companies
- Must have at least two individual directors
- Must appoint an **auditor**. Annual financial report must be prepared and filed with the SFC
- Accommodates an umbrella fund structure with segregated liability between its sub-funds
- Failure to comply with the Code on OFC may lead to the **cancellation of registration of the OFC** and **revocation of license** of the Investment Manager by the SFC

OFC structure



Tax treatment

- Tax treatment relatively clear

Advantages

- Provide an alternative structure for fund manager, investor may prefer regulated Hong Kong fund over traditional Cayman fund
- Simple structure, align fund domicile and fund management location
- No economic substance requirement
- Reduce cost and meet global/regional compliance requirements
- May be able to get a Hong Kong Certificate of Residence Status

OFC under the Fund Exemptions - key considerations

- Tax treatment of management fees and performance fees has been contentious in Hong Kong
- Deeming provisions on Hong Kong resident investors unless the fund is a bona fide widely held fund

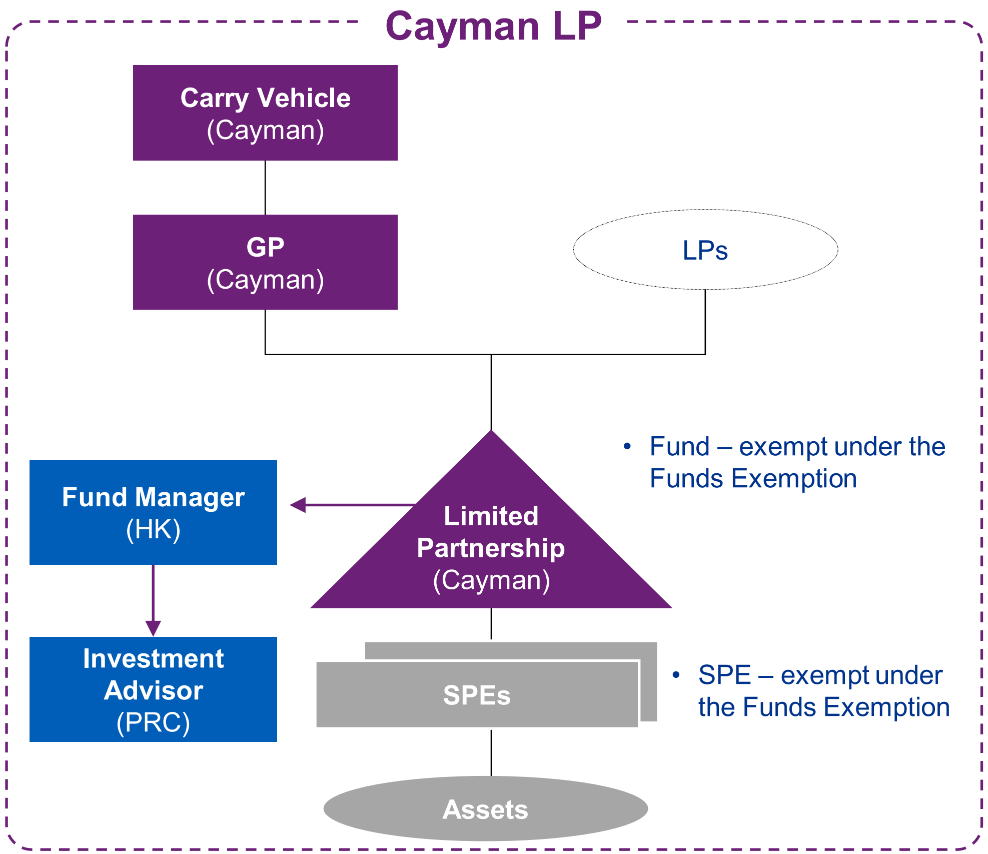
Grant Scheme for Open-ended Fund Companies

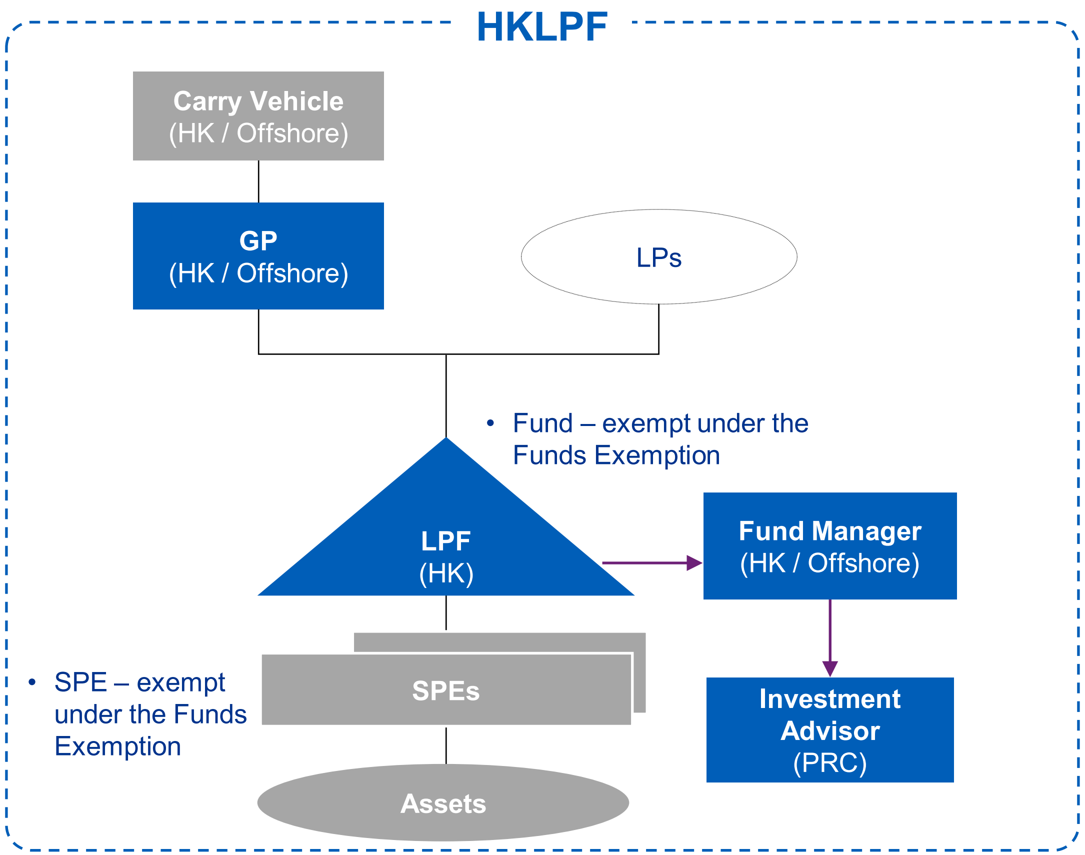
- Administered by the Hong Kong SFC, a subsidy program funded by the Hong Kong Government
- Provide subsidies for qualified OFCs to set up in Hong Kong
- Cover 70% of professional fees accrued by managers establishing companies in, or re-domiciling companies to, Hong Kong and which become registered as an OFC, subject to a cap of HK$1 million per OFC
- Types of fees may be reimbursed under the subsidy:
  - ➢ legal fees for the preparation of incorporation
  - ➢ accounting and tax advisor fees
  - ➢ fees charged by fund administrators, company secretaries, corporate service providers and regulatory consultants
  - ➢ listing agent fees incurred for listed OFCs
  - ➢ does not include any registration or license fees paid to the SFC, or annual audits fee 3-year scheme from 10 May 2021 until 9 May 2024. First come first served
- A two-year claw back if the OFC move away from Hong Kong
- Not apply to newly set up sub-funds under an existing OFC structure

Hong Kong Limited Partnership Fund (HKLPF) regime

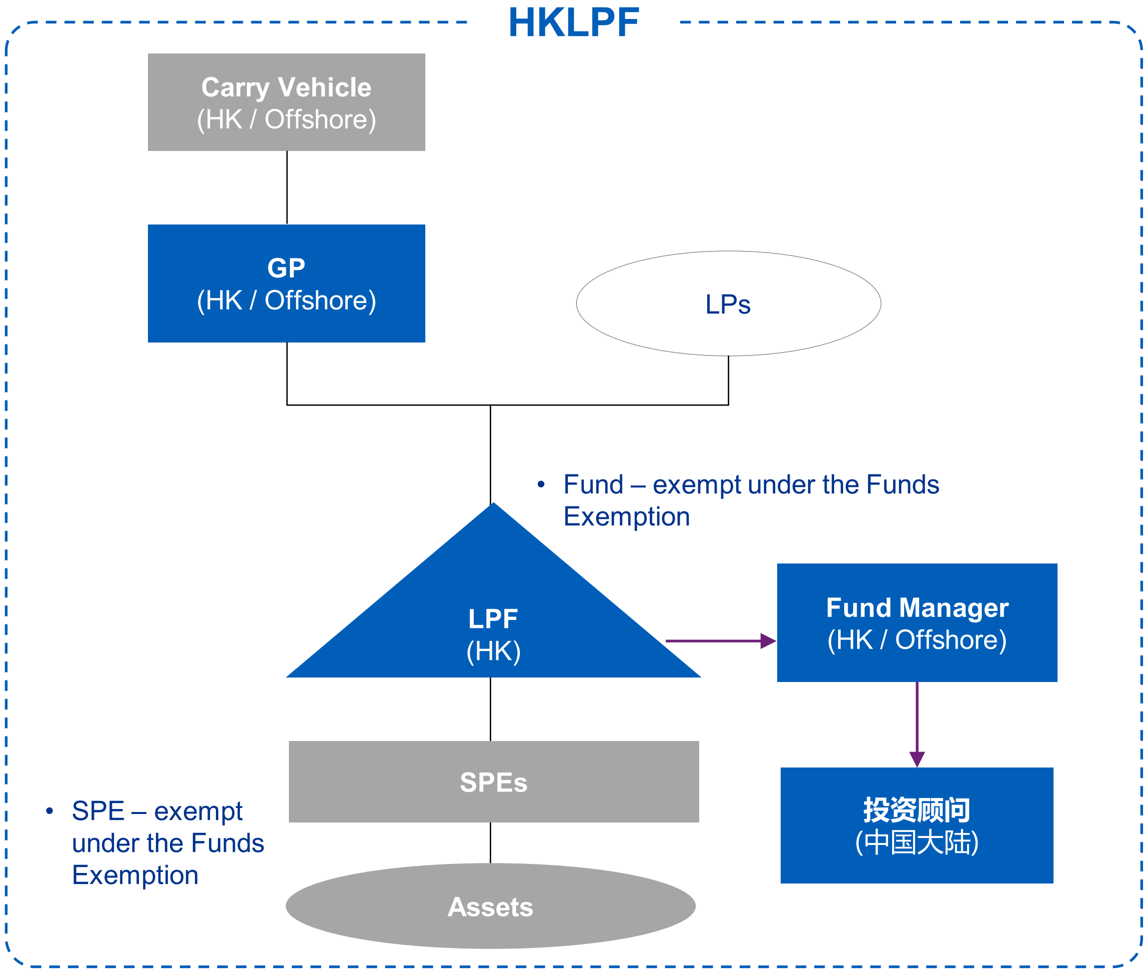
LPF - contrast with traditional Cayman fund structure

The structure of HKLPF and Cayman LP are essentially the same





LPF - simplified structure



- The LPF Ordinance was passed on 31 August 2021. As of Sep 2021, there are more than 300 LPF establishment

Key features

- Constituted by Limited Partnership Agreement
- Registered with the Registrar of Companies as an LPF
- With one GP and at least one LP (2 years grace period to raise third party capital otherwise risk of being strike off)
- Must appoint an Investment Manager, or the GP itself carries out the day-to-day investment management functions
- GP can be an individual, a company, a limited partnership / a LPF
- Has a registered office in HK

Tax

- An LPF will be exempt from HK Profits Tax if the Funds Exemption regime applies
- No HK stamp duty on issuance / transfer / withdrawal of LPF interests
- HK tax filing obligation
- Annual audit requirement

Key elements in the LPF regime

- Align the fund with where the management substance is located, especially in light of the OECD's BEPS Action Plan
- The Fund may be able to enjoy HK's extensive double tax treaty network
- As good as other traditional funds
- Business-friendly
- Low set up, maintenance & compliance costs
- Tax exemption at Fund and SPE level
- Clarity around taxation of carried interest
- Clarity around taxation of management fees between HK and offshore

LPF vis-à-vis typical Cayman fund vehicles

	LPF	Typical Cayman LP structure
Registration fee	US$390 (HK$3,034)	>US$4,000
Annual return filing fee	US$13 (HK$105)	>US$1,000
Custodian	Not mandatory	Mandatory
Audit	Local (HK) auditors appointment	Local auditors appointment
Accounting standards	No specified requirements	IFRS or GAAP in non-high risk jurisdictions

Advantages of LPF

Simple and robust regime

Low cost of registration and annual return filing

Suitable for different fund investment strategies

Flexible capital contribution and profit distribution

No fund size requirements; Fund managers have no minimum expenditure requirements

Clear tax treatment of carried interest

Funds Exemption regime

No requirements of economic substance law

Align fund domicile and management location, enhance the chance of getting a certificate of residence

Provide an alternative fund vehicle for "onshoring" of fund

Funds Exemption

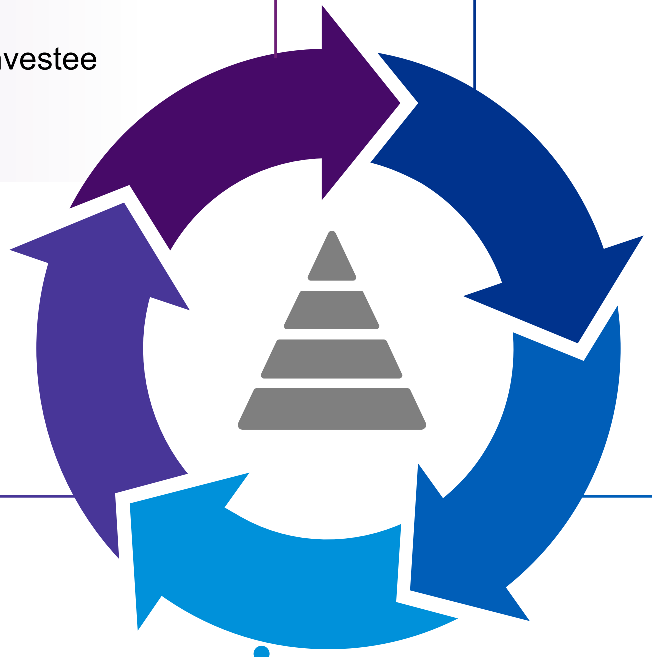
Key framework of the Funds Exemption

Tax exemption on SPEs

- holding and administering investments in investee private companies

Fund

- "Collective investment scheme" in the Securities and Futures Ordinance
- No restriction on residency of the Fund



Deeming provisions

- on certain HK resident investors (>30%) unless the Fund is a bona fide widely held fund

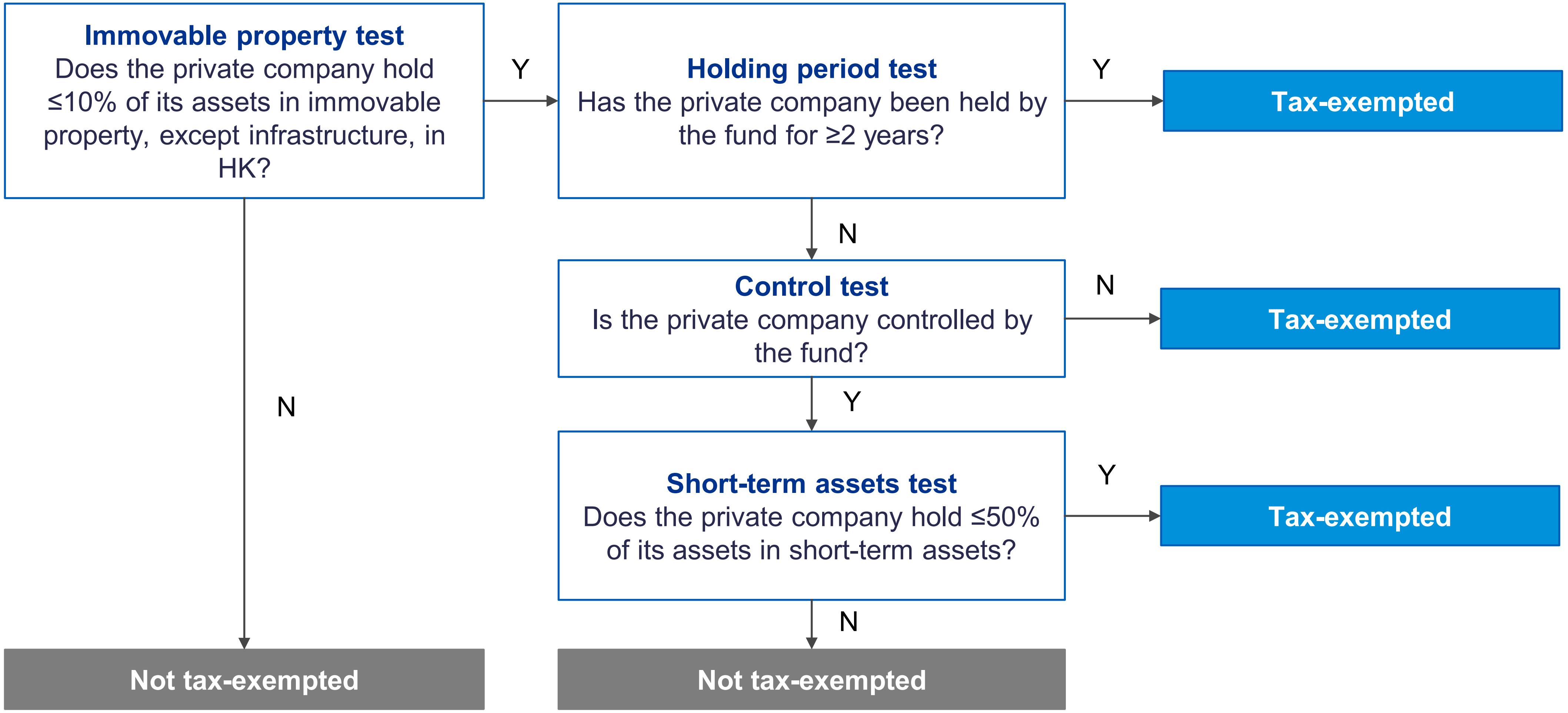
Qualifying transactions

- Listed securities (shares, stocks, debentures, bonds)
- Private companies
- Income from incidental transactions subject to 5% threshold
- **No tainting** on the overall tax exemption status for non-qualifying transactions

SFC licensed

- Or Fund itself is a qualifying fund

Test on investment in private company



Tax concession on Carried Interest

Recap on Carried Interest tax concession framework

- The Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021 (the Ordinance) was gazette on 7 May 2021
- For qualifying carried interest received by or accrued on or after **1 April 2020**, 0% profits tax rate and the exclusion of 100% of eligible carried interest from employment income for the calculation of salaries tax
- Eligible carried interest should arise from qualify transactions, essentially are private equity investments exempted under the Funds Exemption
- Qualifying carry recipients need to provide investment management services to the Fund and meet minimum activity requirements
- The Fund is required to be certified by the HKMA, the Certification Guideline was issued on 16 July 2021

Fund Re-domiciliation

Purpose of the Fund Re-domiciliation Mechanism

- The introduction of HKLPF regime provide an alternative to fund manager to set up an onshore investment fund, which also significantly enhance the attractiveness of Hong Kong as a fund domicile

- Despite the warm welcome from the industry, there is a lack of a re-domiciliation mechanism to allow offshore investment funds to re-domicile to Hong Kong, which has weakened the regime

- Majority of the investment funds in the market are established outside Hong Kong. However, the cost of maintaining an offshore fund has risen, and many of the substantial activities have been performed for Hong Kong. The industry have been urging for introducing an re-domiciliation mechanism to enable the migration of offshore fund into Hong Kong

- In response to the industry's feedback, the Hong Kong Government gazette on 2 July 2021 the Securities and Futures (Amendment) Bill 2021 and the Limited Partnership Fund and Business Registration Legislation (Amendment) Bill 2021 ("the Bills"). The Bills are currently under legislative process, once completed, the amendments will be effective from 1 November 2021.

- The proposed fund re-domiciliation regime would help attract existing non-Hong Kong funds to set up and operate in Hong Kong. This can create new business opportunities for the asset and wealth management sector, help consolidate Hong Kong's status as an international asset and wealth management centre and enhance our status as an international financial centre.

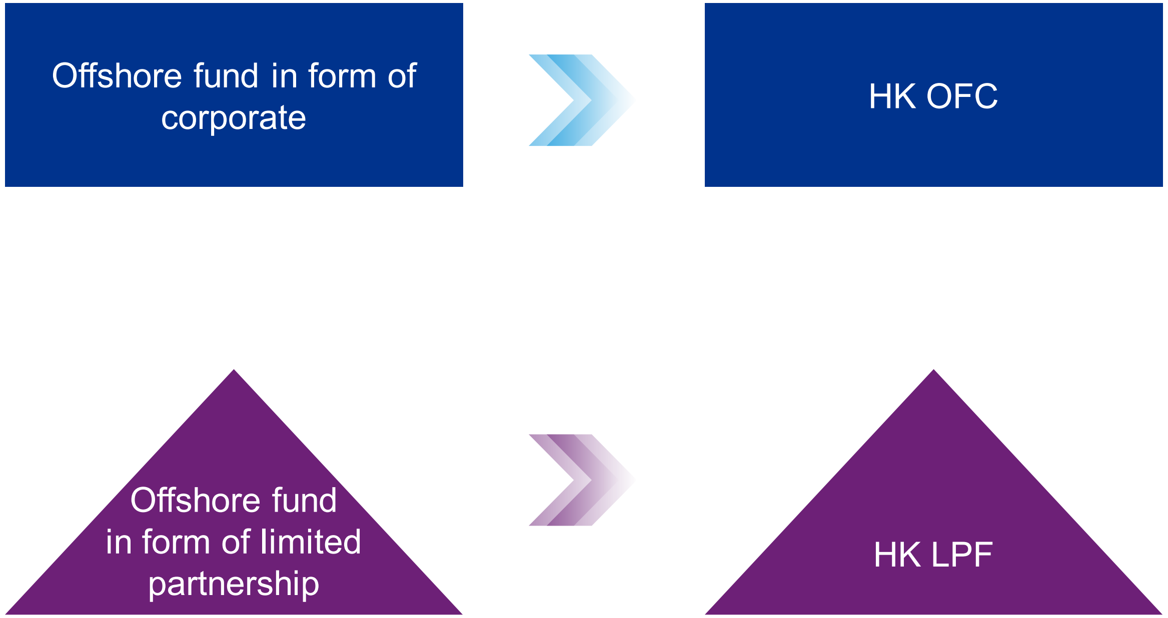
Summary of the Fund Re-domiciliation Mechanism

Proposed mechanism

- An offshore fund set up in corporate or limited partnership form is eligible to be registered as an OFC or LPF in Hong Kong respectively, if it meets the same set of eligibility requirements for a new fund to be registered as an OFC or an LPF
- Re-domiciliation provides for the preservation of the continuity of the fund, including contracts made and property acquired, or render defective any legal proceedings commenced or continued by, or on behalf of or against the fund.
- The proposed mechanisms do not operate to create a new legal entity (which will necessitate dissolution procedures of the original fund)

Tax aspect

- The Funds Exemption also applies to funds re-domciled to Hong Kong, where conditions are met
- The re-domiciliation of a fund does not amount to a transfer of assets of the fund or a change in the beneficial ownership of the assets of the fund, therefore it would not give rise to any stamp duty implications



Proposed application process

	OFC	LPF
Application	Made to the Registrar of Company ("RoC")	Submitted by a Hong Kong law firm, or a solicitor admitted to practice in Hong Kong, on behalf of the fund, to the RoC
Documents / information required	• Name and place of establishment • Constitutional document and certification of incorporation / establishment • A certificate from the board of directors, confirming:- a) that the proposed re-domiciliation is not prohibited by and has been approved in accordance with the corporation's constitutive document; b) that the intended deregistration of the corporation in the place of incorporation is not prohibited under the law of that place or by the corporation's constitutive document and any consent to the intended deregistration required under any contract has been obtained; c) the solvency of the corporation and each of its sub-funds (if any); d) the absence of any petition for winding-up, liquidation, receivership or compromise in respect of the corporation or any of its sub-funds (if any); and e) service of notice of the proposed re-domiciliation on all of its creditors	• Name and place of establishment • Constitutional document and certification of incorporation / establishment • A statement confirming:- a) any consent to the proposed registration as an LPF and the intended deregistration of the fund in its place of establishment required by any contract entered into by or on behalf of the fund has been obtained or waived b) the intended deregistration of the fund in its place of c) establishment is not prohibited under the law of that place or by any agreement entered into among the partners in the fund; and the proposed general partner understands that if the fund is registered as an LPF, the RoC may strike the name of the fund off the LPF Register if the fund is not deregistered in its place of establishment within 60 days after re-domiciliation or the period as may be extended by the RoC
Deregister from offshore location	After the issue of the certificate of registration, the fund will be required to be deregistered in its place of establishment within 60 days (unless further extension is granted)	

KPMG

Consultation Paper on Code on Pooled Retirement Funds (PRF Code)

Arion Yiu
Partner
Asset Management
KPMG China
arion.yiu@kpmg.com

Background information about PRF

What is PRF?

- PRFs are collective investment schemes authorised by the SFC under the SFO and the PRF Code
- PRFs enable multiple ORSO schemes to gain exposure to underlying investment portfolios

Statistics about PRFs

At the time, the consultation was launched:

- 33 PRFs and 409 portfolios by 19 product providers (14 groups)
- AuM: $73B
- Participation by 2900+ ORSO schemes and around 75,000 members
- by 19 product providers (14 groups)

As of today:

- 33 PRFs, 421 portfolios by 19 product providers (14 groups)
- 16 new investment portfolios in 2021 (net increase: 12)

Summary of Key Proposed Changes in the PRF Code

On 18 December 2020, the SFC issued the public consultation paper on proposed amendments to the PRF Code. The proposed changes align certain requirements to those applicable to unit trusts and investment-linked assurance schemes in the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products. The consultation was closed on 19 March 2021.

Key proposed changes

- Introduction of specific requirements for different types of investment portfolios
- Introduction of requirements in relation to fund operations (e.g. valuation and pricing, dealing, reporting, pricing errors, suspension and deferral of dealings, and transactions with connected persons)
- Introduction of obligations for key operators (i.e. product providers, trustees, management companies and insurance companies)
- Strengthening requirements for trustees of PRFs (i.e. enhancement of annual independent internal control review requirements and submission of an internal control review report to the SFC)

More details on the Key Proposed Changes

General

- Categorise the PRF and investment portfolios as one of the following types:
  - Fund investing in SFC-authroised funds
  - Cash management portfolio
  - Guaranteed fund
  - Direct investment fund

Product Providers

- Formerly referred as “applicant companies”
- Must be appointed for each PRF and investment portfolios
- Responsible for observing or procuring other relevant parties to observe all the requirements of the Code
- Need to comply with the principals and requirements including disclosure requirements and ongoing monitoring of the product and information to investors set out under the Overarching Principles Section of the SFC Handbook
- Ensure the relevant parties are properly qualified for the performance of their respective duties and functions and the discharge of their respective obligations under the PRF Code
- Ensure the PRFs and investment portfolios are designed fairly and operated according to their product designs on an ongoing basis

Management Company

- Every direct investment fund must have a management company
- Management company should be licensed by or registered with the SFC to carry on a business in asset management and should also be currently managing fund(s) authorized by the Commission under the UT Code
- General obligations of Management Company (reference to Chapter 5.10 of the UT Code), such as
  - Manage the PRFs and investment portfolio in accordance with the constitutive documents and the Code
  - Maintain proper books and records
  - Representative and agents appointed for the PRFs possess sufficient know-how, expertise and experience
  - Put in place proper risk management and control systems

More details on the Key Proposed Changes (continued)

Trustee

- Internal control review reference to Appendix G to the UT Code
- Annual submission of internal of internal control report to SFC <u>unless</u> providing written confirmation to confirm the applicable internal control measures in respect of SFC-authroised funds also apply to the PRF and investment portfolios under its trusteeship
- General obligations of Trustee (reference to Chapter 4.5 of the UT Code), such as
  - Custody of assets
  - Subscription and redemption monitoring
  - Valuation/price/net asset value calculation
  - Investment process/monitoring
  - Service providers monitoring
  - Breach reporting
  - Transactions with connected persons
- Assume the obligations of a management company under the Code when no management company is appointed for the PRFs or investment portfolios

Insurance Company

- Every PRF and investment portfolios which is constituted as an insurance policy must be issued by an insurance company
- General obligation of Insurance Company is the same as a Trustee (reference to Chapter 4.5 of the UT Code)
- Assume the obligations of a management company under the Code when no management company is appointed for the PRFs or investment portfolios

Operational and Disclosure Requirements

- Disclosure requirements and templates for principal brochure and constitutive documents for each four types of investment portfolio (Appendix A and B to the Code)
- Investment restrictions for each four types of investment portfolios
- Other operational requirements including maintain a register of ORSO schemes, pricing, issue and redemption and dealing of the PRF and investment portfolios

Implementation Schedule for the PRF Code

<table>
<tr><th>Topics</th><th>Provisions of the PRF Code</th><th>New schemes with all new operators</th><th>New schemes with any combination of new operators and existing operators</th><th>New schemes with all existing operators</th><th>Existing schemes with existing operators</th></tr>
<tr><td>Obligations of key operators</td><td>Ch 4, 5, 6 and 6A</td><td>Effective immediately</td><td>Effective immediately (new operator)

12-month transitional period (existing operator)</td><td>12-month transitional period</td><td>12-month transitional period</td></tr>
<tr><td>Fund operations</td><td>Ch 8, 10 and 11</td><td>Effective immediately</td><td colspan="3">12-month transitional period</td></tr>
<tr><td>Trustee’s internal control review</td><td>Ch 6 and Appendix E</td><td>Effective immediately</td><td colspan="3">Effective immediately (new trustee)

12-month transitional period (existing trustee)</td></tr>
<tr><td>Appointment of Mgmt Co and investment restrictions</td><td>Ch 8</td><td colspan="3">Effective immediately</td><td>12-month transitional period</td></tr>
<tr><td>General matters</td><td>Ch 1, 2 and 3</td><td colspan="4">Effective immediately</td></tr>
<tr><td>Overarching principles</td><td>Ch 4</td><td colspan="4">Effective immediately</td></tr>
<tr><td>Hong Kong representatives</td><td>Ch 7</td><td colspan="4">Effective immediately</td></tr>
<tr><td>Principal brochure</td><td>Ch 9 and Appendix A</td><td>Effective immediately</td><td colspan="2">Effective immediately (specific requirements for different types of investment portfolios)

12-month transitional period (fund operations and other matters)</td><td>12-month transitional period</td></tr>
<tr><td>Constitutive documents</td><td>Appendix B</td><td>Effective immediately</td><td colspan="2">Effective immediately (specific requirements for different types of investment portfolios)

12-month transitional period (fund operations and other matters)</td><td>12-month transitional period</td></tr>
</table>

What PRF Providers need to do?

	What PRF providers need to do?
1 Obligations for key operators of PRF	*Review governance and oversight mechanism, including key roles and responsibilities and governing documents for product providers, insurers, trustee, investment manager* and fund operations for PRF.*
2 Enhanced disclosure requirements in principal brochures	*Understand current disclosure processes including key controls and approvals and compare PRF's principal brochures / brochures against templates prescribed by the PRF Code.*
3 Trustee internal control review	*Understand the trustee's fiduciary and oversight responsibilities for PRF and review the key governance mechanisms with reference to the PRF Code.*
4 Fund operation requirements	*Review existing documentation on management of PRF and validate against the PRF Code – safekeeping of assets, fund valuations and pricing, pricing errors, reconciliations, processes for failed trades, suspension and deferral of dealings, segregation of assets, transaction with connected persons etc.*
5 Requirements for PRF	*Examine current structure of PRF to ensure compliance with the requirements of the PRF Code.*

Thank you

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.