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The Hong Kong Institute of Directors

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26 June 2014

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Consultation on OFC  
Financial Services Branch  
FSTB  
24/F  
Central Government Offices  
2 Tim Mei Avenue  
Tamar  
Hong Kong

Dear Sirs

**Re: Consultation Paper on Open-Ended Fund Companies**

**2013-2014 理事會 Council:-**

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楊俊偉 Anthony Yeung

翁月華女士 Ms Linda Y W Yung

容永祺 Samuel W K Yung SBS MH JP

The Hong Kong Institute of Directors (“HKIoD”) is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong’s premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong’s international status.

In developing the response, we have consulted our members and organised focused discussions.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. 2889 9986.

With best regards

Yours sincerely  
The Hong Kong Institute of Directors

Dr Carlye Tsui  
Chief Executive Officer

cc: Dr Kelvin Wong, Chairman of Council, HKIoD  
Mr Henry Lai, Deputy Chairman, HKIoD & Chairman,  
Corporate Governance Policies Committee

Issued on: 26 June 2014

## Consultation Paper on Open-Ended Fund Companies

In relation to the captioned Consultation Paper, the Hong Kong Institute of Directors (“HKIoD”) is pleased to present its views and comments.

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### General comments

HKIoD supports the further development of Hong Kong as international financial center. A stronger more diversified asset management industry is one key component to this ambition. HKIoD agrees Hong Kong can benefit from more choices of legal forms of investment funds.

Hong Kong is currently already a major destination for fund distribution. To permit open-ended fund companies, or OFCs, should indeed enhance Hong Kong’s fund manufacturing capabilities. This should mean more jobs for fund administration and fund servicing work, to add more variety to the sales and marketing job functions that now make up the asset management workforce.

OFCs are like ordinary companies in that they have boards of directors. The fund directors oversee the management and operations of the company being the fund and have a fiduciary duty to represent the interest of the shareholders of the fund. Unlike ordinary companies, however, OFCs do not have operations in the ordinary sense. There are no employees and there are no assets other than the cash and investments it holds. A fund is typically externally managed. Fund directors oversee these service providers, most notably the investment adviser.

The differences between ordinary companies and that of OFCs define the role of fund directors. They are the watch dogs for the fund and its shareholders, to police conflicts of interests and compliance with regulations.

HKIoD recognises the utility of having interested directors. For an OFC to have at least one interested director who is employed or otherwise affiliated with the fund’s adviser may actually enhance the board’s effectiveness. The interested directors would have knowledge of the adviser’s operations. They could help foster open communication with the adviser and in turn, more direct accountability on the adviser’s part.

The consultation paper merely proposes at least one independent out of a minimum of two directors. HKIoD believes there are good grounds to require majority independent out of a minimum of three directors. Some key decisions to be taken by an OFC board should require majority independent vote.

With our proposal, independence is key. The independent directors should have a control over the process for identifying and nominating OFC directors to ensure true independence. Independent directors should also set their own compensation, in order to ensure the independence.

OFC directors should have the benefits of proper shields of liability in performing their duties. OFC directors need rules that will protect them when they make good faith business judgment and decisions. They should have the right to be indemnified from fund assets for liabilities (including legal expenses) incurred by them as defendants or witnesses in fund-related actions.

Funds tend to have a lesser likelihood for becoming insolvent, so indemnification generally affords good protection. But still, to cover situations where indemnity is not available or has become worthless, OFC directors should have available to them proper insurance coverage to protect themselves from liabilities.

OFC directorship involves complex and technical subject matters. Candidates should have a good measure of competence before taking office. They should be expected to continually upgrade and improve their skills and knowledge. There should also be widely-accepted and recognized reference guides to their conduct and behavior. HKIoD will be happy to work with the Administration, the SFC and other professional groups or organizations in these aspects.

We note that the details of the eligibility criteria of individual directors, their functions and duties, and corporate governance standards applicable to OFCs will be subject matter for further consultation. HKIoD will be happy to work with the Administration and the SFO in developing the new OFC legislation and the OFC Code.

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### **Responses to specific questions**

Subject to the foregoing general comments, we respond to the specific consultation questions, as follows:-

Question 1: Do you agree with the overarching principles for OFCs?

HKIoD response:

- AGREE
- In particular, we agree with the notion that privately offered funds should be given more flexibility to pursue their investment strategies.

Question 2: Do you consider it agreeable to set out the legislative framework for OFC in the SFO and the relevant subsidiary legislation in the proposed manner?

HKIoD response:

- AGREE

Question 3: Do you think the proposed scope of the code and guidelines could adequately cater for the OFC regime? If not, what other essential features should the codes and guidelines include?

HKIoD response:

- ADEQUATE

Question 4: Do you agree with the proposal that the SFC should be the primary regulator of OFCs?

HKIoD response:

- AGREE

Question 5: Do you agree with the proposed role and functions of CR in the OFC regime?

HKIoD response:

- AGREE

Question 6: Do you agree with the proposed role of ORO and SFC in respect of proposed termination and winding up arrangements for OFCs?

HKIoD response:

- AGREE

Question 7: Do you think the proposed features comprise the essential features of an OFC? If not, what other essential features should an OFC possess?

HKIoD response:

- AGREE in general
- Our proposal is for an OFC board to comprise a majority of independent directors. See the general comments.

Question 8: Do you agree with the proposed features for the Board of Directors? Do you think the proposed structure of the Board and the proposed criteria of directors will be able to render adequate investor protection to those investing in OFCs? Or do you think the proposed structure is too onerous, and would hinder the development of OFCs in Hong Kong?

HKIoD response:

- Our proposal is for an OFC board to comprise a majority of independent directors. See the general comments.
- We note that the details of the eligibility criteria of individual directors, their functions and duties, and corporate governance standards applicable to OFCs will be subject matter for further consultation. HKIoD will be happy to work with the Administration and the SFO in developing the new OFC legislation and the OFC Code.

Question 9: Do you agree that the OFC board must delegate the day-to-day management and investment functions of the OFC to an investment manager who is licensed by or registered with the SFC to carry out Type 9 (asset management) regulated activity?

HKIoD response

- AGREE

Question 10: Do you think the proposal to require a custodian in the OFC structure could foster the protection of investors in an OFC? Do you consider the proposed requirements and duties for a custodian adequate to meet this objective?

HKIoD response:

- As to the requirement of have custodian, AGREE
- As to the adequacy of the proposed duties of custodian, AGREE

Question 11: Do you agree with the proposed arrangements in relation to the incorporation of OFC?

HKIoD response:

- AGREE

Question 12: Do you consider the proposed naming convention provides sufficient level of clarity to investors?

HKIoD response:

- SUFFICIENT

Question 13: Do you agree that the proposed Articles are adequate? What features should the Articles include?

HKIoD response:

- AGREE in general
- Our proposal is for an OFC board to comprise a majority of independent directors. See the general comments. The Articles should also include provisions on the nomination and appointment of directors, provisions on board size and its composition, provisions on how to determine and safeguard independence for the independent directors, etc.

Question 14: Do you consider the proposed investment scope and strategies could provide a competitive framework for OFCs in Hong Kong with sufficient safeguards for investor protection?

HKIoD response:

- AGREE
- We note that the consultation paper takes the position that the asset classes in which a Hong Kong OFC may invest should fall within the definition of securities and futures (and OTC derivatives). We agree. The desire for private investors to invest in other asset classes can be achieved via other investment products or through other forms of investment holdings.
- As a related note, once OFCs are introduced to Hong Kong, the worry may be for corporate entities not initially formed as investment funds to inadvertently become more like OFCs in fact than an operating company for commercial business and trade. The overall regulatory framework will need to guard against such possibilities.

Question 15: Do you agree with the proposed arrangements in relation to the offer of OFC shares?

HKIoD response:

- AGREE
- We note privately offered funds are given more flexibility. We agree. See our response to Question 1.

Question 16: Do you agree with the proposed arrangements regarding corporate administration?

HKIoD response:

- AGREE

Question 17: Do you agree with the proposed arrangements in relation to fund operation? Are the proposed principles and arrangements adequate to cater for the practical operation for OFCs?

HKIoD response:

- AGREE in general
- The distribution policy should require approval by the OFC board and by the independent directors. Our proposal is for an OFC board to comprise a majority of independent directors. See the general comments.
- We note privately offered funds are given more flexibility. We agree. See our response to Question 1.

Question 18: Do you agree with the proposed arrangements in relation to protected cells?

HKIoD response:

- AGREE

Question 19: Do you think the proposed termination procedures are adequate to provide an expedient way for terminating a solvent OFC?

HKIoD response:

- ADEQUATE

Question 20: Do you have any comments on the proposed termination, winding up and dissolution arrangements for OFCs, including the proposed power to be given to the custodian to petition to the court to wind up an OFC?

HKIoD response:

- NO, we do not have specific comments at this time. We do believe this is an area where all stakeholders should keep in mind as Hong Kong move towards modernizing its corporate insolvency law regime.

Question 21: Do you consider the proposed powers are essential and proportionate?

HKIoD response:

- AGREE

Question 22: Do you think the existing profits tax exemption regimes for public funds authorised under section 104 of the SFO / bona fide widely held regulated funds and offshore funds are adequate to cater for OFCs?

HKIoD response:

- ADEQUATE

Question 23: Do you consider that the proposed stamp duty treatment on sale and transfer of shares in OFCs can cater for the market needs?

HKIoD response:

- AGREE IT CAN

Question 24: Do you consider the proposed tax filing arrangement agreeable?

HKIoD response:

- AGREEABLE

<END>