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18 December 2015

Ms Joyce Ho

Principal Assistant Secretary for Financial Services

Financial Services and the Treasury Bureau

24/F

Central Government Offices

2 Tim Mei Avenue

Tamar

Hong Kong

Dear Ms Ho

**HKIoD's Response to the Legislative Proposals to Introduce An
Open-ended Fund Company Regime in Hong Kong**

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: Mr Henry Lai, Chairman of Council, HKIoD & Chairman,
Corporate Governance Policies Committee

Issued on: 18 December 2015

Legislative Proposals to Introduce an Open-ended Fund Company Regime in Hong Kong

HKIoD is pleased to have the opportunity to comment on the legislative proposals to introduce an open-ended fund company regime in Hong Kong.

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HKIoD previously commented on the subject matter in our 19 June 2014 submission in response to the Open-ended Fund Companies Consultation Paper (March 2014). We stand by the views presented in that submission.

HKIoD supports the further development of Hong Kong as international financial centre. A stronger more diversified asset management industry is one key component to this direction. 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.

The role of OFC directors

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 rules and regulations.

There are some general eligibility requirements for appointment as director (e.g., body corporate not to act as director, minimum age to be director, undischarged bankrupt not to act as director except with leave, embodied in Section 377M and 377N and 377O, respectively). We concur with these requirements.

Should require majority independent out of a minimum of three directors

The legislative proposals merely require a minimum of two directors. Section 377L(1) refers. We take issue with this requirement.

The March 2014 Consultation Paper did require the "independence" of at least one director. Consultation Paper Para 44 refers. Director's independence, however, appears to have not been mentioned in the present legislative proposals. That may be because the issue of directors' independence is considered a subject matter for the OFC Rules and OFC Code. The

present legislative proposals appear to be gearing towards a primary, enabling legislation with detailed operational and procedural matters to be set out in subsidiary legislation(s) (or OFC Rules) and an OFC Code to be published by the SFC. Consultation Paper para 46 and Legislative Proposal para 5(a) and 8 refers.

Although an OFC Code could be useful, HKIoD believes the present legislative proposals should put more focus on the role of OFC directors, and 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. In our formulation, 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.

Nonetheless, HKIoD recognises the utility of having interested directors on an OFC board. 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.

We believe "majority independent out of a minimum of three directors" is appropriate, suitable and ultimately beneficial to shareholders of an OFC.

Tools to perform, shields to protect

The legislative proposals would stipulate that a director of an OFC owes the same fiduciary and other (statutory) duties (e.g., the duty of reasonable care, skill and diligence) that are owed by a director of an ordinary company. Section 377L(3) refers. We concur.

Yet, 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 recognised 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.

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