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KEY ISSUES IN GETTING AN SFC LICENSE FOR ALTERNATIVE FUND MANAGERS (Part I)

One of the first challenges facing potential alternative fund managers (ie hedge fund, private equity and real estate fund managers) when setting up their new fund management business in HK is getting the appropriate SFC license. This article will examine the key issues often faced by potential alternative fund managers when getting an SFC license and the main requirements for getting an SFC license.

There are 10 types of SFC licenses each covering a different type of “regulated activity”. The first question often asked by potential fund managers is whether or not they need to get a license for one or more of these. Whereas the differences between some of these regulated activities are conceptually and practically easily distinguishable, some are differentiated by subtle nuances and may, at first, appear overlapping.

The most relevant types of licenses concerning alternative fund managers are Type 1 (Dealing in Securities), Type 4 (Advising on Securities) and Type 9 (Asset Management) licenses. Whether the fund manager needs one or more of these depends on the exact nature of the business and activities the fund manager intends to undertake in Hong Kong. Although prima facie a fund manager managing a fund from Hong Kong would require at least a Type 9 license, the Hong Kong Securities and Futures Ordinance and its subsidiary legislations, regulations and guidelines do provide a number of important exemptions which may apply to the fund manager. One example is the “private company” exemption – the definition of “securities” excludes shares in a company which is a private company” within the meaning of the Hong Kong Companies Ordinance. Activities which constitute “asset management” which require a license involve the management of a portfolio of “securities” and hence, if the portfolio managed by the fund manager consists only of shares in “private companies” as defined then it may be arguable that the fund manager may not require a license for such activities on the basis of the exemption noted above. Whereas this exemption would not apply to hedge funds trading listed stocks (because such listed stocks would not fall within the exemption of being shares in a “private company”), this argument may apply to some private equity fund managers whose portfolio consists only of investments in “private companies”. Similarly it may be arguable that managing a portfolio of physical real estate assets may fall outside of the ambit of “managing a portfolio of securities” on the basis that such portfolio of physical real estate assets is not portfolio of securities or any one of the categories of financial assets or instruments in relation to which the activity of “asset management” is regulated.

If the portfolio which the fund manager manages does consist of securities or any one of the other types of financial assets or instruments in relation to which the activity of asset

management is regulated, and that no other exemption applies, then it should be safe to conclude that the fund manager would need a Type 9 license. However, a question is often raised as to whether the activity of managing a portfolio of securities undertaken by the fund manager is actually conducted in Hong Kong. In a typical hedge fund where its trader places trades on a frequent basis at a desk in Hong Kong on a discretionary basis, it is clear that such activities amount to Type 9 asset management activities conducted in Hong Kong. However, less clear is the case of a private equity styled fund where investment decisions are less frequently made and, when made, is made by a committee (eg an investment committee) which may be composed of members some of whom may be resident in Hong Kong and some of whom may be resident outside of Hong Kong. This type of arrangement begs the question as to whether investment decisions are actually made in Hong Kong and, therefore, whether it triggers any licensing requirements in Hong Kong. The answer to this question depends on a number of factors including, for example, whether the Hong Kong based personnel of the investment decision making body individually or collectively has the veto power, whether such investment decision making body is constituted by the offshore fund entity or the Hong Kong based fund manager, amongst many other factors. The conclusion of such analysis may well be that investment decisions are made outside of Hong Kong (ie no Type 9 activities are conducted in Hong Kong), and that the Hong Kong based personnel is conducting advisory activities only (hence Type 4 regulated activities). This would mean that the license which may be required is the Type 4 license and not the Type 9 license.

We regularly assist our clients to determine the most appropriate SFC license which they should apply and provide assistance in the application process. Besides some of the key licensing issues identified above, the potential fund manager should also take into consideration a multitude of other tax, legal and regulatory issues when deciding on the mode of its business operation in Hong Kong, the fund structure it will use and the way it will market the funds in Hong Kong. For further details on how we can assist you, please contact us at: ycyenquiry@law-firm.com.hk.

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