

# Chambers

GLOBAL PRACTICE GUIDE

---

Definitive global law guides offering  
comparative analysis from top-ranked lawyers

# Investment Funds

**Hong Kong**

**Law and Practice**

Lorna Xin Chen, Sean Murphy,  
Anil Motwani and Iris Wang  
**Shearman & Sterling**

chambers.com

# 2020

# HONG KONG

## Law and Practice

*Contributed by:*

*Lorna Xin Chen, Sean Murphy, Anil Motwani and Iris Wang  
Shearman & Sterling see p.10*



## Contents

<b>1. Market Overview</b>	<b>p.3</b>
1.1 State of the Market	p.3
<b>2. Alternative Investment Funds</b>	<b>p.3</b>
2.1 Fund Formation	p.3
2.2 Fund Investment	p.4
2.3 Regulatory Regime	p.4
2.4 Operational Requirements	p.7
2.5 Fund Finance	p.7
2.6 Tax Regime	p.7
<b>3. Retail Funds</b>	<b>p.8</b>
3.1 Fund Formation	p.8
3.2 Fund Investment	p.8
3.3 Regulatory Environment	p.8
3.4 Operational Requirements	p.8
3.5 Fund Finance	p.8
3.6 Tax Regime	p.8
<b>4. Legal, Regulatory or Tax Changes</b>	<b>p.8</b>
4.1 Recent Developments and Proposals for Reform	p.8

## 1. Market Overview

### 1.1 State of the Market

Hong Kong is a leading international financial centre known for its strategic position as a hub and gateway to mainland China, as well as for being one of the world's largest capital markets. Hong Kong is also a principal centre for alternative investments, ranking second in Asia after mainland China for total capital under management by private equity funds (excluding real estate funds), which amounted to USD159 billion as at 25 March 2019. The Hong Kong industry for alternative asset management is strengthened by its diversity. Long a preferred destination for global and regional investment fund managers, more than 200 managers were based in Hong Kong in 2018. For these reasons, Hong Kong is likewise an important jurisdiction for leading pension funds, insurance companies, sovereign wealth funds, family offices and other investors.

Asset management and fund advisory businesses in Hong Kong amounted to HKD16,447 billion as at 31 December 2018, resulting in a moderate drop of 6% as compared to 2017. Nonetheless, the industry for alternative asset management continued to see an increase over the past few years in the number of licensed corporations and personnel. From September 2018 to September 2019, the number of corporations licensed in Hong Kong for Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities – the three types of licences most relevant to alternative asset managers – grew by 7%, 12% and 10%, respectively. Over the same period, the number of licensed representatives in Hong Kong for Type 1, 4 and 9 regulated activities increased respectively by 2%, 8% and 9%.

The continued growth of the alternative asset management sector in Hong Kong also reflects Hong Kong's important role in China's Belt and Road Initiative (BRI), one of Chinese President Xi Jinping's signature initiatives for global infrastructure investment. In addition, the rapid development of the Guangdong–Hong Kong–Macao Greater Bay Area has created an additional need for private investment capital by start-ups in the innovation and technology field.

Hong Kong was well positioned heading into 2020, thanks in part to tax and legal changes initiated in the past few years by the Hong Kong authorities, including an expansion of the current profit tax exemptions, to encourage the use of vehicles formed locally in Hong Kong; amendments to certain codes of conduct regulating fund managers, to strengthen investor confidence in the Hong Kong private funds market; and tightened regulation over funds investing in virtual assets, to support and promote responsible innovation.

In addition, during 2019, a task force was formed to engage in research and discussions over a proposal for a new limited partnership regime in Hong Kong designed specifically for investment funds. If enacted as expected in 2020, the new regime would replace the existing, century-old statute and attract greater fund formation activity in Hong Kong, thereby strengthening Hong Kong's position as a jurisdiction of choice for fund managers.

## 2. Alternative Investment Funds

### 2.1 Fund Formation

#### 2.1.1 Fund Structures

Market practice for private funds that have a managerial or advisory presence in Hong Kong is to form the fund entities in a tax-neutral, offshore jurisdiction, such as the Cayman Islands. Presently, Hong Kong is not often used by advisers and managers for the formation of these fund entities. One factor driving this is the lack of a modern limited partnership law in Hong Kong. If the current 100-year-old ordinance is modernised in 2020, as expected, to match the current needs and expectations of the market as described in **1.1 State of the Market**, then the use of Hong Kong as a fund domicile may soon become more prevalent.

#### 2.1.2 Common Process for Setting up Investment Funds

The common structure of a private fund that has a managerial or advisory presence in Hong Kong consists of (i) a fund entity formed as (a) a limited partnership (if the fund draws down capital over a fixed investment period), (b) a company (if the fund draws down all such capital at closing, as is typical for a hedge fund) or (c) an SPV; (ii) a general partner (if the limited partnership option is used) formed either as a limited partnership or as a company; and (iii) an investment manager or adviser established as a company, typically under the laws of a tax-neutral, offshore jurisdiction, such as the Cayman Islands.

Core fund documents include a limited partnership agreement (in the case of a limited partnership) or a shareholders' agreement and articles of association (in the case of a company), subscription documents, a private placement memorandum (where applicable), side letters entered into with investors (where applicable), an investment management agreement and/or an investment advisory agreement.

#### 2.1.3 Limited Liability

Persons investing in private funds set up in commonly employed offshore jurisdictions generally will not be deemed to be taking part in the management of the business of these funds (and will therefore benefit from the safeguard of limited liability) so long as these persons act as passive, economic investors in connec-

tion with the investment, and locally qualified law firms may provide comfort on this point in the form of legal opinions. The contours of the exact legal requirements for how an investor may act as “passive” and “economic” varies across jurisdictions. Generally, the ability for investors to sit on a fund-level advisory committee that reviews conflicts of interest and other ancillary matters presented by fund management should not, by itself, result in the loss of these investors’ limited liability protection.

## 2.1.4 Disclosure Requirements

The Hong Kong Securities and Futures Commission (SFC) is the primary regulator of private funds and fund managers and advisers in Hong Kong. Hong Kong-based investment managers and advisers with SFC licences are subject to regulation under certain codes of conduct, including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code) and the Fund Manager Code of Conduct (FMCC), which prescribe a set of matters that are required to be disclosed to investors. The FMCC, for example, requires disclosure of cross trades, leverage arrangements, securities lending, repo and reverse repo transactions, risk management policies, custody arrangements and so forth, which are usually contained in marketing documents, such as a term sheet or private placement memorandum.

## 2.2 Fund Investment

### 2.2.1 Types of Investors in Alternative Funds

Hong Kong is an international market with many of the same key investor types that operate in other important jurisdictions, including pension funds, insurance companies, private banks, wealth management firms, funds of funds, high net worth individuals and family offices. Some of these institutional investors are branch offices of mainland China-based operations.

### 2.2.2 Legal Structures Used by Fund Managers

Investors in Hong Kong prefer to invest in private funds set up in a tax-neutral jurisdiction that has a track record of recognising the limited liability of investors.

As described in **2.1.2 Common Process for Setting up Investment Funds**, the common structure of a private fund that has a managerial or advisory presence in Hong Kong would consist of (i) a fund entity structured as (a) a limited partnership, (b) a company or (c) an SPV; (ii) a general partner (assuming the limited partnership option is used) structured either as a limited partnership or as a company; and (iii) an investment manager or adviser structured as a company, all organised under the laws of the Cayman Islands.

Typically, a Cayman Islands-domiciled private fund with a team of investment professionals based in and working out of Hong Kong would also include a Hong Kong investment manager or

adviser entity that employs these professionals and provides investment advice and operational support in respect of the investments.

### 2.2.3 Restrictions on Investors

Due to the periodic tightening of RMB capital outflows by the monetary regulators in mainland China, investors that have to source capital from their mainland China affiliate(s) may encounter difficulty in funding capital calls on a timely basis. In recent years, regulators in mainland China have revisited and tightened control on inbound and outbound investments. Prior to making a private fund investment, investors would be advised to carefully review and understand the impact of these rules, updates thereto and relevant law enforcement actions. Certain investors are subject to special regulations based on their investor type. For example, regulators in mainland China have steepened the requirements for China-based insurance companies investing in private funds, requiring such companies to report extensive, and potentially sensitive, information on their investments to mainland China government authorities.

## 2.3 Regulatory Regime

### 2.3.1 Regulatory Regime

Private funds set up in tax-neutral, offshore jurisdictions that have a Hong Kong-based team of investment professionals would typically retain, directly or indirectly, a Hong Kong investment manager or adviser.

The primary securities legislation in Hong Kong is the Securities and Futures Ordinance (SFO). Activities of an investment manager or adviser could, depending on the facts and circumstances, come within various categories of regulated activities under the SFO, including:

- selling fund interests to residents in Hong Kong;
- conducting selling activities in Hong Kong;
- deal sourcing and execution of transactions;
- making recommendations and advising with respect to potential deals; and
- making investment decisions for the investment fund under management.

A Hong Kong investment manager or adviser entity, therefore, will usually be licensed under the SFC for conducting regulated activities in Hong Kong. The three types of licences that such manager or adviser is most likely to hold are Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management). Moreover, a manager registered in a jurisdiction other than Hong Kong that intends to conduct a regulated activity in Hong Kong, such as offering private fund interests to residents in Hong Kong or providing fund management or

advisory services, must still comply with the private placement rule as detailed in

**2.3.6 Marketing of Alternative Funds** and the SFC licensing regime as detailed in **2.3 Regulatory Regime**, as applicable.

The core principle behind the Hong Kong licensing regime is that applicants must demonstrate, to the satisfaction of the SFC, that these applicants are fit and proper (SFO, Section 129) to be licensed. Being fit and proper involves, broadly, being financially sound, competent, honest, reputable and reliable. To obtain an SFC licence, an applicant would need to satisfy standards relating to the competence of responsible officers and other senior management and relating also to the adequacy of financial resources.

With regard to responsible officers (ROs), an applicant must appoint at least two such ROs to be tasked with direct supervision of the conduct of each proposed regulated activity, with at least one RO being available at all times to supervise each of the proposed regulated activities and at least one RO being designated as an executive director.

In addition to ROs, any individual who carries on a regulated activity on behalf of the corporation will similarly be required to obtain a licence as a representative (LRs) accredited to such corporation. As with ROs, LR applicants must satisfy the SFC that such LR has fulfilled the fit and proper requirement and must pass a related competency test.

### 2.3.2 Requirements for Non-local Service Providers

Non-local service providers operating in Hong Kong are not, to the best of the authors' knowledge, subject to an additional legal registration requirement solely on account of being non-local.

### 2.3.3 Local Regulatory Requirements for Non-local Managers

If a non-local manager actively markets its services or products (whether by itself or by another person on its behalf) from outside Hong Kong to the public, which, if provided in Hong Kong, would constitute the carrying on of a business in regulated activity under the SFO, then such non-local manager should adhere to the Hong Kong licensing regime as discussed herein.

### 2.3.4 Regulatory Approval Process

As indicated in **2.3.1 Regulatory Regime**, the SFO prohibits "active marketing" of any service by any person (including those operating from an offshore jurisdiction) to the public if that would constitute a regulated activity if undertaken in Hong Kong, unless such person has obtained an appropriate licence.

SFC guidance suggests that the following factors would be considered in reaching the conclusion that this "active marketing" threshold has been crossed:

- there is a detailed marketing plan to promote the relevant services;
- the services are extensively advertised via marketing means such as direct mail, advertisements in local newspapers, the use of broadcasts or other "push" technology over the internet (as compared with situations where such services are only passively available; eg, on a "take it or leave it" basis);
- the related marketing is conducted in a concerted manner and executed in accordance with a plan or schedule that indicates a continuing service rather than a one-off exercise;
- the services are packaged to target the public of Hong Kong; eg, written in Chinese and denominated in Hong Kong dollars; and
- the services are not sought out by the customers on such customers' own initiative.

### 2.3.5 Rules Concerning Marketing of Alternative Funds

The SFO stipulates ten types of regulated activities, the most relevant of which for a private equity fund sponsor are Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management).

Type 1 (dealing in securities) regulated activity includes the making or offering to make an agreement with another person or inducing or attempting to induce another person to enter into an agreement for or with the view to acquiring or disposing of securities. If a company engages in the distribution and sale of securities, such as limited partnership interests or shares in a company, a Type 1 licence would thus be required. In addition, if a company engages in deal sourcing and the execution of private equity transactions, including negotiations with a target company, then this conduct may also constitute Type 1 regulated activity.

Type 4 (advising on securities) regulated activity includes the giving of advice on whether to acquire or dispose of securities. If a company provides investment advice for which remuneration is received, then, unless such advisory activities are wholly incidental to Type 1 regulated activity, the company will need to apply for and obtain a Type 4 licence.

Type 9 (asset management) regulated activity includes the managing of a real estate investment scheme or securities or futures contracts. If a company provides portfolio management services and exercises discretionary investment authority to make investment decisions for its clients, then the company will require a Type 9 licence.

As the profile of each private fund management team or sponsor with a managerial or advisory presence in Hong Kong may differ depending on such factors as strategy, personnel, business capabilities and operational models, many firms decide to apply for one or a combination of the Type 1, 4, or 9 licences, while some other firms instead seek to rely on an exemption from the licensing requirements. Alternatively, some firms may choose to acquire a corporation that is already licensed and, through the acquisition, conduct the desired type of regulated activity. The SFO sets out various exemptions from the licensing requirements, the most relevant of which are profiled below.

A company may not need a licence for certain regulated activities if these activities are performed in a manner that is wholly incidental to the carrying out of another regulated activity for which the company is already licensed. For example, if a company holds a Type 9 licence, then that company may rely on the incidental exemption to carry out related Type 1 and Type 4 regulated activities, provided that the preceding activities are undertaken solely for the purposes of the company's asset management business.

A company may not need a licence for Type 4 or Type 9 regulated activity if the company provides the relevant advice or services solely to (i) the company's wholly owned subsidiaries, (ii) the company's holding company that holds all of the company's issued shares or (iii) other wholly owned subsidiaries of the company's holding company.

### 2.3.6 Marketing of Alternative Funds

Offerings in Hong Kong of interests in private funds structured as partnerships or trusts (in the case of closed-end funds) are subject to regulation under the SFO. Offerings in Hong Kong of shares or debentures issued by private investment funds structured as companies (in the case of open-end funds, such as hedge funds) are subject to regulation both under the SFO and the Companies Ordinance.

Offering documents relating to securities offered to members of the Hong Kong public, whether offered by a licensed person or not, must be authorised by the SFC unless an exemption applies.

One of the most commonly used exemptions applies to offers made solely to "professional investors", within the meaning of the SFO and its relevant subsidiary legislation. "Professional investors" broadly encompasses financial institutions, insurance companies, investment companies, retirement schemes, pension plans, government entities and certain high net worth individuals and large entities. If fund interests are marketed in Hong Kong, the relevant investors should be provided with a supplemental Hong Kong investor questionnaire to confirm and document their professional investor status. It should be

noted, however, that the admission by a fund of certain types of professional investors, including individuals, may cause such fund to be subject to enhanced compliance and due diligence requirements.

To the extent all Hong Kong offerees cannot meet the professional investor standard, another exemption is available under current market practices for offerings to not more than 50 offerees in Hong Kong. Although the offering documents for the types of private offers listed above are not required to comply with prospectus content requirements, they should include an appropriate securities legend to highlight that the offering documents have not been reviewed by any regulatory authority in Hong Kong and that investors are encouraged to seek independent professional advice.

### 2.3.7 Investor Protection Rules

As mentioned in 2.3.6 **Marketing of Alternative Funds**, one exemption commonly relied upon by a private fund to facilitate private placement in Hong Kong is an offering limited to "professional investors". The term "professional investor", for this purpose, is defined in the SFO and its relevant subsidiary legislation, and is broadly split into three categories:

- institutional professional investors;
- individual professional investors; and
- corporate professional investors.

Institutional professional investors generally include authorised or regulated entities, such as recognised exchange companies, recognised clearing houses, recognised exchange controllers, recognised investor compensation companies, authorised financial institutions and authorised collective investment schemes. Individual professional investors and corporate professional investors are usually determined on the basis of their asset value or portfolio size, including:

- a trust corporation having been entrusted under one or more trusts of which it acts as a trustee with total assets of not less than HKD40 million;
- an individual, either alone or with any of his or her associates on a joint account, having a portfolio of not less than HKD8 million;
- a corporation or partnership having a portfolio of not less than HKD8 million or total assets of not less than HKD40 million; and
- a corporation whose principal business is to hold investments and that is wholly owned by a professional investor under the three points above.

## 2.3.8 Approach of the Regulator

The SFC is the main regulator of funds and fund managers and advisers in Hong Kong. The SFC derives its investigative, remedial and disciplinary powers from the SFO and subsidiary legislation. The SFO has empowered the SFC with multiple roles. The SFC's principal responsibilities include maintaining and promoting the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry. The SFC's scope of work includes licensing and supervising persons that conduct activities under the SFC's regulatory purview.

The SFC often publishes guidance on regulatory matters and is timely to act when dealing with pressing concerns. The SFC often consults the industry and public at large prior to enacting significant changes in regulation. In recent years, the SFC has focused on addressing irregularities in the market, developing regulatory approaches toward new, emerging asset classes such as virtual assets, strengthening oversight of fund managers and advisers, and taking account of the multi-jurisdictional nature of private equity.

The SFC, where applicable, initiates disciplinary actions against fund managers and advisers for misconduct. For example, the SFC recently reprimanded and fined an investment manager HKD3.5 million for regulatory breaches, including unlicensed dealing and delay in reporting a breach to the SFC. The SFC posts notices of enforcement actions to its website as a way of offering and providing insight into its regulatory approach and priorities. The SFC has also tightened its regulation on virtual assets and complex products in recent years, as detailed in **4.1 Recent Developments and Proposals for Reform**.

## 2.4 Operational Requirements

Fund managers in Hong Kong have certain reporting obligations under the SFO, the Code, the FMCC and other applicable codes and guidelines. For example, licensed or registered persons are required by the SFC, on an ongoing basis, to submit records of audited accounts. Pursuant to the FMCC, fund managers may also be requested by the SFC on an ongoing basis to provide additional information to help enable the SFC to monitor systemic risk. Such information may cover matters such as fund-level leverage, the terms of securities lending and the substance and balance of other assets and liabilities. In addition, the Code requires licensed or registered persons to report to the SFC immediately following certain specified events, such as compliance breaches and the initiation of legal proceedings.

The FMCC, in particular, requires a fund manager that is responsible for overall fund operations to disclose to investors the expected maximum level of leverage that may be employed on behalf of such fund and the basis for calculating this leverage, which should be reasonable and prudent. Moreover, the

FMCC provides that a fund manager should not borrow funds from a connected person on behalf of a fund, unless interest charged and fees levied in connection with the relevant loan are no higher than the prevailing commercial rate for a similar loan.

Although a breach of the Code or the FMCC should not directly cause the relevant licensed or registered persons to become subject to legal action, such a breach could reflect negatively on the fitness and propriety of the sanctioned persons and may thus create a basis for disciplinary action.

## 2.5 Fund Finance

Asian private equity or venture capital funds have traditionally sought financing to bridge a funding gap, either by way of a capital call or subscription credit facility. Such facilities are useful to private equity and venture capital funds as they could access funds quickly to capitalise on investment opportunities, while waiting for capital calls from limited partners to arrive. Drawdown under a capital call facility could be arranged within as little as one business day, whereas a capital call could take ten business days or more. This firm has also seen capital call facilities being utilised to bridge the funding gap between the time in which an acquisition is completed and drawdown under a permanent asset level-financing.

If seeking to incur financing or leverage, these funds are most likely to do so by entering into capital call and subscription credit facilities from banks, including international banks with a Hong Kong presence. Capital call and subscription facilities are structured as a revolving facility with the private equity or venture capital fund as borrower. The facilities are secured by an assignment of capital call rights under the limited partnership agreement and unfunded commitments of the limited partners, together with a charge over the accounts to which capital calls are to be deposited. The facilities are not usually secured by any of the fund's underlying investment assets.

## 2.6 Tax Regime

Sponsors in Hong Kong prefer to set up private funds in certain offshore jurisdictions to enjoy tax neutrality or the otherwise preferential tax rates and treaty benefits that these jurisdictions may offer. Funds that are domiciled outside of Hong Kong may be exempted from the Hong Kong profits tax if certain conditions under the Inland Revenue Ordinance (Cap 112) are met. The profit tax implications may vary for the asset-based management fees and variable performance fees that are often payable to fund managers.

Although a Hong Kong-based investment manager or adviser may advise on the operation of the fund, a portion of profits and income may remain with a separate Cayman-based fund manager or adviser, pursuant to appropriate commercial arrange-



ments. In recent years, taxation of fund managers and advisers in Hong Kong has drawn closer scrutiny by the Inland Revenue Department (IRD) in terms of both the nature and source of income derived and the sufficiency of amounts received by the Hong Kong-based investment manager or adviser.

In the current market, sponsors of private funds would be advised to carefully review the service agreements among managerial entities, alongside the underlying compensation arrangements, in order to anticipate and defend against any challenges from the IRD.

## 3. Retail Funds

### 3.1 Fund Formation

#### 3.1.1 Fund Structures

This topic is outside the coverage scope for this article.

#### 3.1.2 Common Process for Setting up Investment Funds

This topic is outside the coverage scope for this article.

#### 3.1.3 Limited Liability

This topic is outside the coverage scope for this article.

#### 3.1.4 Disclosure Requirements

This topic is outside the coverage scope for this article.

### 3.2 Fund Investment

#### 3.2.1 Types of Investors in Retail Funds

This topic is outside the coverage scope for this article.

#### 3.2.2 Legal Structures Used by Fund Managers

This topic is outside the coverage scope for this article.

#### 3.2.3 Restrictions on Investors

This topic is outside the coverage scope for this article.

### 3.3 Regulatory Environment

#### 3.3.1 Regulatory Regime

This topic is outside the coverage scope for this article.

#### 3.3.2 Requirements for Non-local Service Providers

This topic is outside the coverage scope for this article.

#### 3.3.3 Local Regulatory Requirements for Non-local Managers

This topic is outside the coverage scope for this article.

#### 3.3.4 Regulatory Approval Process

This topic is outside the coverage scope for this article.

#### 3.3.5 Rules Concerning Marketing of Retail Funds

This topic is outside the coverage scope for this article.

#### 3.3.6 Marketing of Retail Funds

This topic is outside the coverage scope for this article.

#### 3.3.7 Investor Protection Rules

This topic is outside the coverage scope for this article.

#### 3.3.8 Approach of the Regulator

This topic is outside the coverage scope for this article.

### 3.4 Operational Requirements

This topic is outside the coverage scope for this article.

### 3.5 Fund Finance

This topic is outside the coverage scope for this article.

### 3.6 Tax Regime

This topic is outside the coverage scope for this article.

## 4. Legal, Regulatory or Tax Changes

### 4.1 Recent Developments and Proposals for Reform

During 2019, a task force was formed to develop a proposal for a modern limited partnership regime in Hong Kong. Benefiting from research into Hong Kong's market landscape as well as international trends, the proposal should be better suited to the current needs and desires of market participants in Hong Kong's alternative asset management industry than the existing regime, which was last amended in 1924. If the updated regime is enacted in 2020, as projected, then funds in the Cayman Islands or elsewhere being operationally managed from Hong Kong may re-domicile to Hong Kong (and, correspondingly, successor vintages of such funds may be formed in Hong Kong), thereby aligning legal structures with business activities, and contributing to Hong Kong's ongoing growth as a global financial centre.

In light of the growing investor interest in virtual assets (including exposure to such assets through private equity funds) and the growth in unlicensed trading platform operators in Hong Kong, the SFC on 1 November 2018 announced a new regulatory framework for the governance of virtual assets. Among other things, the SFC announced that terms and conditions will be imposed on licensed corporations that manage or plan to manage portfolios with (i) a stated investment objective to invest in virtual assets, or (ii) an intention to invest 10% or more of the gross asset value of the portfolio in virtual assets (collectively, Virtual Asset Fund Managers).



On 4 October 2019, the SFC published Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets, which further sets out the terms and conditions that will be imposed on all Virtual Asset Fund Managers, subject to minor variations and elaborations depending on an individual Virtual Asset Fund Manager's business model and circumstances. These terms and conditions are mostly principle-based and will be imposed on Virtual Asset Fund Managers by way of a licensing condition. Failure to observe such licensing condition may be considered as misconduct under the SFO and may adversely affect the fitness and properness of a Virtual Asset Fund Manager and even result in disciplinary action by the SFC.

The SFC issued a circular on 13 June 2019 on implementation of regulatory requirements for online and offline sale of complex products. A complex product is "an investment product whose terms, features and risks are not reasonably likely to be understood by a retail investor because of its complex structure." Factors to determine whether an investment product is complex or not are further set out in the Guidelines on Online Distribution and Advisory Platforms and the Code, including (i) whether a secondary market is available for the investment product at publicly available prices, (ii) whether there is adequate and transparent information about the investment product available to retail investors, and (iii) whether any features or terms of the investment product might render the investment illiquid and/or difficult to value. Thus, a private fund is likely to be considered a complex product that is subject to enhanced requirements relating to suitability, the provision of information and warning statements.

On 7 January 2020, the SFC issued guidance on the licensing obligations of private equity firms and family offices that conduct business in Hong Kong. In a circular to private equity firms seeking to be licensed, the SFC clarifies certain existing licensing requirements, such as those applicable to general partners and investment committee members, offering co-investment opportunities and fund marketing activities. The circular also clarifies how the SFC assesses private equity firms' discretionary investment authority and investments in securities of private companies, as well as the industry experience requirement for their responsible officers. A separate circular provides general guidance for family offices intending to carry out asset management or other services in Hong Kong and explains the potential implications for both single and multi-family offices. Licensing exemptions, or carve-outs, may be available depending on how a family office operates.

**Shearman & Sterling** has over 850 lawyers around the world, nearly half of whom practise outside the USA, speaking more than 60 languages and practising US, English, French, German, Italian, Hong Kong, OHADA and Saudi law. The full-service Investment Funds team is led by lawyers based in Hong Kong, Beijing, London, New York and Tokyo, with support from the firm's global network of offices, advising clients across the full spectrum of investment funds, including private equity, hedge, real estate, infrastructure, growth and venture capital, credit

and special situations, registered mutual (both open-end and closed-end) and UCITS funds. In addition to a deep bench and broad coverage across strategies, the firm has expertise in launching complex policy funds, leading sovereign wealth fund investments and providing advice to ambitious, growing PRC and Hong Kong-based asset managers, as well as advising on funds in other parts of Asia, including Japan, India and Singapore.

## Authors



**Lorna Xin Chen** is the firm's Asia regional managing partner, head of Greater China and the founder and head of the Asia Investment Funds practice. Lorna has 19 years' experience in the investment funds and private equity field, advising clients in the structuring, restructuring, formation

and operation of alternative investment products, including private equity funds, venture capital funds, hedge funds, real estate funds, funds of funds, project funds and co-investment structures. Lorna is a member of the Technical Committee of Hong Kong Venture Capital and Private Equity Association. Her recent publications include the chapters on Hong Kong investment funds in the Chambers Global Practice Guide and The Private Equity Review.



**Sean Murphy** is a counsel with more than a decade of experience advising private investment fund managers and investors in Hong Kong, Singapore and New York. He regularly advises private equity, growth capital, real estate, infrastructure, credit and hedge fund sponsors, as well as

sovereign wealth funds, asset managers and other investors on all aspects of their businesses, including fund structuring and formation, capital raising and marketing, acquisition and disposition of portfolio investments, and fund governance and carry arrangements. He is a member of the Hong Kong Venture Capital and Private Equity Association. Sean is a co-author of chapters on Hong Kong investment funds in the Chambers Global Practice Guide and The Private Equity Review.



**Anil Motwani** is an associate who represents fund sponsors in all major asset classes and is regularly involved in the design and development of alternative investment products and services, and the structuring and restructuring of private equity funds. He also advises private equity

fund sponsors and investors on ongoing operational matters. Anil has extensive experience representing limited partners and general partners in their fund transactions. Anil is a member of the Hong Kong Venture Capital and Private Equity Association. He is a co-author of chapters on Hong Kong investment funds in the Chambers Global Practice Guide and The Private Equity Review.



**Iris Wang** is a registered foreign lawyer who works on transactions for both general partners and limited partners in Asia. She helps private equity and hedge fund sponsors in asset management and funds-related matters, and has accumulated an understanding of fund

structuring and regulatory issues in relation to fund managers. Iris is a member of the Hong Kong Venture Capital and Private Equity Association and is qualified in New York and China. She is a co-author of chapters on Hong Kong investment funds in the Chambers Global Practice Guide and The Private Equity Review.

# HONG KONG LAW AND PRACTICE

---

*Contributed by: Lorna Xin Chen, Sean Murphy, Anil Motwani and Iris Wang, Shearman & Sterling*

## **Shearman & Sterling**

21/F, Gloucester Tower  
The Landmark, 15 Queen's Road  
Central  
Hong Kong SAR

Tel: +852 2978 8000  
Fax: +852 2978 8099  
Email: [info@shearman.com](mailto:info@shearman.com)  
Web: [www.shearman.com](http://www.shearman.com)

