
Marketing Mutual Funds in Hong Kong

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Marketing Mutual Funds in Hong Kong

Introduction

This note considers some of the Hong Kong regulatory issues arising from the marketing of shares in a mutual fund company incorporated outside Hong Kong (the “Fund”) to potential investors in Hong Kong. There are two principal areas to consider: (i) whether the entity marketing the Fund is required to be licensed or registered under the Securities and Futures Ordinance (the “SFO”); and (ii) the restrictions on the making of offers/invitations to the public under the Companies (Winding Up and Miscellaneous Provisions) Ordinance (the “C(WUMP)O”) and under Part IV of the SFO.

Summary

Marketing by the Fund

The Fund can be marketed by the Fund itself without a licence under the SFO only to the limited categories of “professional investors” set out in Part A of Annex A to this note.

Marketing by an Intermediary

The Fund can be marketed by an intermediary which is licensed or registered by the Securities and Futures Commission (the “SFC”) to “deal in securities”:

- i to investors each paying a minimum consideration of HK\$ 500,000 for the shares; or
- ii in circumstances where the total consideration payable for the shares is less than HK\$ 5 million; or
- iii to unlimited numbers of “professional investors” within Parts A and B of Annex A, overseas investors and, subject to meeting the requirements for reliance on the Hong Kong private placement exemption specified in Section 2.1 below, to up to a maximum of 50 other investors.

1. THE HONG KONG LICENSING REQUIREMENTS UNDER THE SECURITIES AND FUTURES ORDINANCE (THE “SFO”)

1.1 Business of Dealing in Securities in Hong Kong

The SFO provides that no person shall carry on a business in a regulated activity without being licensed or registered under the SFO. Carrying on a business is construed widely.

“Dealing in securities” constitutes a regulated activity and is widely defined. A person is “dealing in securities” if he, whether as principal or agent,

makes or offers to make an agreement with another person, or induces or attempts to induce another person to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite securities.

The marketing of the Fund in Hong Kong by the Fund itself or by an intermediary will prima facie constitute dealing in securities.

1.2 Marketing by the Fund

There is a limited exemption from the requirement to be licensed to deal in securities where a person, **as principal**, deals with a person who is a “professional investor” within the limited category of investors set out in Part A of Annex A attached hereto (“Type 1 professionals”).

Only the Fund can rely on this exemption. All marketing activities must therefore be conducted by representatives of the Fund and not representatives of any intermediary (such as an investment manager or placing agent) and all marketing materials must be issued in the name of the Fund itself, in order that the Fund meets the requirement that it is dealing “as principal”.

In addition, the Fund may only market to Type 1 professionals. The definition of Type 1 professionals is however limited. In summary, it includes licensed investment intermediaries, authorised financial institutions, regulated insurance companies, regulated collective investment schemes, government and multilateral agencies. Significantly, Type 1 professionals do **not** include the categories of “high net worth” investors set out in Part B of Annex A or the subsidiaries or holding companies of licensed intermediaries or authorised financial institutions.

The Fund may therefore market shares in itself to Type 1 professionals only without being licensed by the SFC.

1.3 Marketing by an Intermediary

An intermediary would need to be licensed or registered by the SFC to conduct Regulated Activity Type 1 (dealing in securities) in order to market shares in the Fund in Hong Kong, unless an exemption applies.

(i) *Incidental Exemption*

An intermediary licensed for Type 9 regulated activity (asset management) is not required to be licensed for Type 1 regulated activity (dealing in securities), provided that this activity is carried out solely for the purposes of the intermediary’s asset management business. However, the SFC interprets this exemption narrowly. The SFC has said that where a fund manager who is already licensed for Type 9 regulated activity engages in marketing activities relating to funds under its management, it may rely on this incidental exemption. Accordingly, to conduct its fund

management business plus any incidental marketing activities in relation to the funds it manages, the fund manager is only required to be licensed/registered for Type 9.

However, this exemption will not apply if the fund manager markets other funds which are not under its management. Such marketing activities will not be regarded as incidental to the fund manager's Type 9 business, and the fund manager will need to be additionally licensed/registered for Type 1¹.

This exemption is therefore available only where a fund manager holding a Type 9 licence markets shares in a fund under its management.

(ii) *Dealing through a Licensed/Registered Securities Dealer*

An exemption from the requirement to be licensed is available where a person deals through another person who is licensed or registered to deal in securities. Arrangements can therefore be made for the marketing of the Fund to be conducted by a Type 1 licensed/registered intermediary. The exemption will not however apply if the person appointing the licensed intermediary to market the Fund (e.g. the fund manager or the Fund itself) receives any form of commission or other remuneration from the licensed intermediary.

(iii) *Temporary Licence*

If an intermediary is not currently licensed under the SFO, it may be able to apply for a temporary licence for a period of up to three months. The primary requirement for the grant of a corporate temporary licence is that the entity is authorised in its home jurisdiction by a regulator which performs a similar function to the SFC and has the power to investigate and discipline the entity in respect of its conduct in Hong Kong. The SFC has indicated on an informal basis that it would normally take up to 12 weeks to process a full licence for an entity unknown to the SFC, but that it should take less time for temporary licences where the applicant is already licensed in a recognised jurisdiction. They indicated a possible timetable of around one month if the structure is not complicated and around 2 months for less straightforward cases. Marketing must not commence until the temporary licence has been granted. Any representatives of the intermediary involved in the marketing activities would also need to apply for temporary licences.

In practice, obtaining a temporary licence in Hong Kong is difficult. One of the application requirements is that the applicant

¹ Source: SFC FAQs on Licensing Related Matters, Topic 10 – Incidental Exemption, Question 10.6

has lodged an application under section 130(1) SFO for the keeping of records and documents. It is not possible to obtain a temporary licence to carry out regulated activity Type 9 (asset management). A temporary licensee is also prohibited from holding client assets.

1.4 Marketing from outside Hong Kong

An entity (such as a fund manager or placing agent) which markets interests in the Fund to persons in Hong Kong is prima facie “dealing in securities” and will require a Type 1 licence in the absence of an available exemption.

It should also be noted that section 115 SFO expressly prohibits a person “actively marketing” from outside Hong Kong to the Hong Kong public any services which would constitute a regulated activity if provided in Hong Kong, unless that person is registered or licensed by the SFC. According to the FAQs on the SFC website, “actively markets” may include, for example, those who frequently call on Hong Kong investors and market their services (including offering products) and running a mass media programme or internet activities targeting the Hong Kong investing public. The SFO expressly provides for companies and individuals based outside Hong Kong to be eligible to be licensed by the SFC to cater for this.

The marketing of the Fund to the public in Hong Kong by an off-shore intermediary would therefore require the intermediary to be SFO licensed. Members of its staff conducting the marketing activities would also need to be licensed as representatives.

2. THE HONG KONG PROSPECTUS REGIME

Any prospectus distributed in Hong Kong which offers for subscription or purchase shares in or debentures (other than structured products²) of a company incorporated outside Hong Kong must comply with the content and registration requirements set out in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (the “CWUMPO”)³.

A prospectus is defined as any prospectus, notice, circular, brochure, advertisement or other document which:

- **offers** any shares or debentures of a company to **the public** for

² Broadly speaking, structured products are any products with a derivative element. They are defined in Section 1 of Part 1A of Schedule 1 to the SFO to include: a) instruments where some or all of the return or amount due (or both the return and amount due) or the method of settlement is determined by reference to one or more of: (i) changes in the price, value or level (or a range within the price, value or level) of any type of securities, commodity, index, property, interest rate, currency exchange rate or futures contract; (ii) changes in the price, value or level (or a range within the price, value or level) of a basket of more than one type of securities, commodity, index, property, interest rate, currency exchange rate or futures contract; or (iii) the occurrence or non-occurrence of an event or events specified in the instrument (excluding an event or events relating only to the issuer or guarantor of the instrument or to both of them); or (b) regulated investment agreements.

³ Section 342C C(WUMPO)

subscription or purchase; or

- is **calculated to invite offers by the public** to subscribe for or purchase any shares or debentures of a company.

Accordingly any documents distributed to the “public” which contain an offer or invitation to acquire shares in the Fund will be subject to the C(WUMP)O prospectus requirements unless a specific exemption applies.

The prospectus requirements do not apply to public offers of shares which are made verbally, although verbal advertisements and invitations are subject to the prohibition on unauthorised investment advertisements in Hong Kong in Section 103 SFO.

2.1 Exemptions

The Seventeenth Schedule to the C(WUMP)O (the “Seventeenth Schedule”) sets out twelve safe harbours which exclude certain categories of offers from the prospectus regime. The most important of these in terms of the offer of shares in the Fund are the following:

(i) *Professionals Exemption*

The offering documentation for offers to professional investors (as defined in Section 1 of Part 1 of Schedule 1 to the SFO) is excluded from the C(WUMP)O “prospectus” definition and hence from all the C(WUMP)O prospectus requirements.

The definition of professionals which applies for the purposes of this exemption includes all the categories of investors listed in Part A of Annex A to this note (i.e. Type 1 professionals) and those listed in Part B of Annex A (“Type 2 professionals”).

It is therefore possible to market shares in the Fund to the categories of high net worth investors referred to in Part B of Annex A in reliance on this exemption. However, firms offering shares to Type 2 professionals must satisfy themselves that such investors meet the relevant assets or portfolio threshold at the relevant date to qualify as a professional investor.

(ii) *Hong Kong Private Placement Exemption*

An exemption is available for offers made to a maximum of 50 persons in Hong Kong provided that the offer document contains in a prominent position the warning statement specified in Part 3 of the Eighteenth Schedule to the C(WUMP)O (the “specified warning statement”) which is as follows:

“WARNING”

The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.”

In counting the 50 offerees, an offer is taken with any other offer of shares by the same person within the preceding 12 months which relied on the same exemption. Accordingly, it is not possible to increase the number of offerees by staggering placements of the shares.

Where the Hong Kong private placement exemption is to be relied on, the following steps should be taken:

- (a) Each information memorandum issued should be numbered in series and individually addressed to each offeree;
- (b) The information memorandum should include the specified warning statement on the front cover;
- (c) The information memorandum should contain a warning that the addressee may not copy or pass the information memorandum to any other person;
- (d) Subscriptions for shares in the Fund should only be accepted from the offeree and the offeree should only be able to purchase shares in the Fund as principal;
- (e) Placees should be required to agree not to sell their shares in Hong Kong in the 6 months following the allotment of the shares, except in circumstances which do not constitute an “offer to the public” within the meaning of the C(WUMP)O. This is to ensure that the anti-avoidance provisions of Section 343(1) C(WUMP)O are not triggered; and
- (f) There should be no public advertising at all in Hong Kong in relation to the offer of shares in the Fund. This issue of promotional material must be strictly limited to offerees.

It is also possible to combine the professionals exemption and the private placement exemption so that documents offering shares in the Fund to unlimited numbers of professional investors and to a maximum of not more than 50 other persons (who do not qualify as professional investors) will be exempt from the C(WUMP)O prospectus requirements. If reliance is to be placed on both exemptions, no more than 50 copies of the information memorandum should be issued to persons who do not qualify as

professional investors and the steps specified at (a) to (f) above should also be taken in respect of any offers to such persons.

(iii) *Small Offer Exemption*

Offers for which the total consideration payable for the relevant shares does not exceed HK\$ 5 million (or its foreign currency equivalent) are also exempt from the C(WUMP)O prospectus requirements.

In determining whether the HK\$ 5 million condition is satisfied, offers are taken together with any other offer of shares by the same person within the preceding 12 months which relied on the same exemption.

The offer documentation must also contain the specified warning statement in a prominent position.

(iv) *Sophisticated Investor Exemption*

There is an exemption for offers where the minimum consideration payable by any person for the shares is not less than HK\$ 500,000 (or its foreign currency equivalent). The specified warning statement must be included in the offer documentation in a prominent position.

To rely on this exemption, **every** investor must pay a minimum of HK\$ 500,000. If they do so, investors do not additionally need to be “professionals” within the definition referred to above.

(v) *Offers to Persons outside Hong Kong*

References in the safe harbours to an “offer” do not include an offer to the extent that it is made to persons outside Hong Kong⁴. Offers made to persons outside Hong Kong can therefore be disregarded in determining whether any relevant exemption applies. For example, when determining whether the number of offerees are within the 50 person limit allowed under the Hong Kong private placement exemption, it is only necessary to count the number of offerees in Hong Kong.

3. PART IV OF THE SECURITIES AND FUTURES ORDINANCE

3.1 Investment Advertisements in Hong Kong

It is an offence under Section 103 SFO for a person to issue in Hong Kong an advertisement, invitation or document which is or contains an invitation to the public:

⁴ Paragraph 1(b) of Part 4 of the Seventeenth Schedule.

- to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite securities: or
- to acquire an interest in or participate in, or offer to acquire an interest in or participate in, a collective investment scheme,

unless the issue is authorised by the SFC under Section 105(1) SFO or an exemption applies.

“Collective investment scheme” is the term used in the SFO to cover mutual funds, unit trusts and other pooled investment arrangements. The Fund will constitute a collective investment scheme for the purpose of the SFO. It is the SFC’s policy intention that the public offering of both open-ended and closed-end funds should be subject to SFC authorization under the SFO unless specifically exempted.

It should be noted that the SFO regime covers advertisements and invitations made verbally as well as written documents⁵.

3.2 Public Offer

In order for shares in a fund to be marketed to the public in Hong Kong, the fund must be authorised by the SFC under Section 104 SFO. The conditions for authorisation are set out in the Code on Unit Trusts and Mutual Funds. In addition, any invitation to the public to acquire shares in the fund, must be authorised by the SFC under Section 105 SFO.

3.3 Exemptions

There are a number of exemptions from the investment advertisements requirements.

Most importantly in terms of the Fund, any invitation to the public which relates to an offer within the safe harbours of the Seventeenth Schedule to the C(WUMP)O, is also exempt from the prohibition on unauthorised investment advertisements in Hong Kong by virtue of Section 103(2)(ga) SFO. Accordingly, SFC authorisation is not required for invitations relating to an offer:

- (i) to investors each paying a minimum consideration of HK\$ 500,000 for the shares; or
- (ii) in circumstances where the total consideration payable for the shares is less than HK\$ 5 million; or
- (iii) to unlimited numbers of “professional investors” within Parts A and B of Annex A, overseas investors and up to a maximum

⁵ See the definitions of “advertisement” and “invitation” in Section 102 SFO.

of 50 other investors.

3.3.1 Advertisements issued to professional investors

This exemption is available in respect of advertisements for securities and for collective investment schemes.

The definition of professionals which applies for the purposes of this exemption includes all the categories of investors listed in Part A of Annex A to this note (i.e. Type 1 professionals) and those listed in Part B of Annex A (“Type 2 professionals”).

It is therefore possible to market interests in the Fund to the categories of high net worth investors referred to in Part B of Annex A in reliance on this exemption. However, the offeror must use appropriate methods to establish that persons specified in paragraphs 10, 11, 12 and 13 of Part B meet the relevant assets or portfolio threshold at the relevant date⁶ to qualify as a professional investor. Firms should keep proper records of their assessment process so as to demonstrate that they have exercised professional judgement and have reached a reasonable conclusion that their clients meet the relevant thresholds.

4. **INTERNET MARKETING**

The SFC has stated that the provisions of the SFO and C(WUMP)O relating to the advertisement, offering and dealing of collective investment schemes (i.e. funds) apply equally to activities conducted over the internet. The sending of marketing material over the internet is therefore subject to the same restrictions under the C(WUMP)O and the SFO.

The SFC’s primary concern is to regulate activities which are targeted at persons residing in Hong Kong or are detrimental to the interests of the Hong Kong investing public or to the market integrity of Hong Kong. Factors which will be taken into account in determining whether an advertisement is targeted at Hong Kong investors include:

- (i) Whether the information is targeted via “push” technology (such as e-mail) to persons residing in Hong Kong;
- (ii) Whether the information provided over the internet appears to target Hong Kong residents (such as the use of local distribution agents; references to Hong Kong dollars; the use of Chinese language and the publication in a Hong Kong newspaper or publication of the internet address where such information can be accessed).

⁶ “Relevant date” for these purposes means in the case of any advertisement, invitation or document to enter an agreement to acquire or subscribe for securities, the date of issue of the advertisement, invitation or document (Section 2 of the Securities and Futures (Professional Investor) Rules).

4.1 THE HONG KONG LICENSING REQUIREMENTS

As mentioned in Section 1.4 above, marketing activities conducted from outside Hong Kong which target Hong Kong investors may trigger the SFO's licensing requirements. The SFC's Guidance Note on Internet Regulation published in 1999 (the "SFC Guidance Note") states that the SFC will require persons who use the internet to induce people residing in Hong Kong to deal in securities to be registered or licensed by the SFC.

4.2 THE HONG KONG PROSPECTUS REGIME AND PART IV OF THE SFO

The SFC Guidance Note also states that the requirements of the C(WUMP)O prospectus regime and the prohibition on unauthorised invitations to the public apply to invitations and offers made by means of the internet.

In addition, internet advertisements to acquire shares in a fund are likely to be caught by Section 103(10) SFO which contains deeming provisions whereby:

- (i) any advertisement, invitation or document which consists of or contains information likely to lead, directly or indirectly, to the doing of any act referred to in Section 103(1) is regarded as an advertisement, invitation or document which is or contains an invitation to do such act; and
- (ii) any advertisement, invitation or document which is or contains an invitation directed at, or the contents of which are likely to be accessed or read (whether concurrently or otherwise) by, the public is deemed to be or contain an invitation to the public.

Where the information memorandum is to be sent via the internet, it should therefore be sent by individual e-mails (rather than by posting on a website) and include the appropriate Hong Kong selling restrictions and, where the private placement exemption is relied on, legends warning the addressees not to pass the information to any other person.

ANNEX A

DEFINITION OF “PROFESSIONAL INVESTORS”

Part A

1. An exchange company, clearing house, exchange controller or investor compensation company recognised as such under the SFO, or a person authorised to provide automated trading services under Section 95(2) of the SFO.
2. An intermediary (i.e. a corporation licensed under the SFO to conduct any regulated activity), or a person carrying on the business of providing investment services which is regulated under the law of any place outside Hong Kong.
3. An authorised financial institution (i.e. a bank, restricted licence bank or deposit taking company authorised under the Banking Ordinance (Cap. 155 of Hong Kong), or a bank which is not an authorised financial institution but is regulated under the law of any place outside Hong Kong.
4. An insurer authorised under the Insurance Companies Ordinance (Cap. 41) of Hong Kong, or a person carrying on insurance business and regulated under the law of any place outside Hong Kong.
5.
 - (i) A collective investment scheme authorised under Section 104 of the SFO; or
 - (ii) A scheme which is similarly constituted under the law of any place outside Hong Kong and, if it is regulated under the law of that place, is permitted to be operated under that law,or a person who operates such scheme.
6. A registered scheme as defined in Section 2(1) of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) of Hong Kong, or its constituent Fund as defined in Section 2 of the Mandatory Provident Fund Schemes (General) Regulation, or a person who, in relation to any such registered scheme, is an approved trustee or service provider as defined in Section 2(1) of that ordinance, or who is an investment manager of any such registered scheme or constituent Fund.
7.
 - (i) A registered scheme as defined in Section 2(1) of the Occupational Retirement Schemes Ordinance (Cap.426) of Hong Kong; or
 - (ii) An offshore scheme as defined in Section 2(1) of that ordinance which, if regulated under the law of the place where it is domiciled, is permitted to be operated under the law of such place,

or an administrator as defined in that Ordinance of any such scheme.

8. A government (other than a municipal government authority), an institution which performs the functions of a central bank, or a multilateral agency.

Part B

9. A corporation which is:
- (i) a wholly owned subsidiary of:
 - (A) an intermediary, or a person carrying on the business of providing investment services which is regulated under the law of any place outside Hong Kong; or
 - (B) an authorised financial institution, or a bank which is not an authorised financial institution but is regulated under the law of any place outside Hong Kong;
 - (ii) a holding company which holds all the issued share capital of:
 - (A) an intermediary, or a person carrying on the business of providing investment services which is regulated under the law of any place outside Hong Kong; or
 - (B) an authorised financial institution, or a bank which is not an authorised financial institution but is regulated under the law of any place outside Hong Kong; or
 - (iii) any other wholly owned subsidiary of a holding company referred to in sub-paragraph (ii).
10. A trust corporation holding assets on trust with a total value of not less than HK\$40 million or its foreign currency equivalent:
- (i) as stated in the most recent audited financial statement prepared in respect of the trust corporation within 16 months before the relevant date;
 - (ii) as ascertained by referring to one or more audited financial statements, each being the most recent audited financial statement, prepared in respect of the trust or any of the trusts and within 16 months before the relevant date; or
 - (iii) as ascertained by referring to one or more custodian statements issued to the trust corporation in respect of the trust or any of the trusts within 12 months before the relevant date*.

11. An individual, either alone or with his spouse or children on a joint account, having a portfolio⁷ of not less than HK\$8 million or its foreign currency equivalent:
- (i) as stated in a certificate issued by an auditor or a certified public accountant of the individual within 12 months before the relevant date; or
 - (ii) as ascertained by referring to one or more custodian statements issued to the individual (either alone or with the associate) within 12 months before the relevant date*.
12. A corporation or partnership having either:
- (i) a portfolio of not less than HK\$8 million or its foreign currency equivalent; or
 - (ii) total assets of not less than HK\$40 million or its foreign currency equivalent,
- as ascertained by referring to:
- (i) the most recent audited financial statement prepared in respect of the corporation or partnership (as the case may be) within 16 months before the relevant date; or
 - (ii) one or more custodian statements issued to the corporation or partnership (as the case may be) within 12 months before the relevant date*; and
13. A corporation the sole business of which is to hold investments and which is wholly owned by one or more of the following persons: (i) a trust corporation that falls within the description in paragraph (10); (ii) an individual who, either alone or with associates on a joint account, falls within the description in paragraph (11); (iii) a corporation that falls within the description in paragraph (12); and (iv) a partnership that falls within the description in paragraph (12).

* Note

Firms may use methods that are appropriate in the circumstances to satisfy themselves that an investor within paragraphs 10, 11 and 12 above meets the relevant assets or portfolio threshold at the relevant date⁸ to qualify as a professional investor as an alternative to using the methods set out in those paragraphs. Firms

⁷ The term “portfolio” is defined as a portfolio of securities, money held by a custodian or a certificate of deposit issued by a Hong Kong authorised financial institution or a bank which is regulated in any other jurisdiction.

⁸ “Relevant date” for these purposes means in the case of any advertisement, invitation or document to enter an agreement to acquire or subscribe for securities, the date of issue of the advertisement, invitation or document (Section 2 of the Securities and Futures (Professional Investor) Rules).

should keep proper records of their assessment process so as to demonstrate that they have exercised professional judgement and have reached a reasonable conclusion that their clients meet the relevant thresholds.

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