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# SFC Adopts New Approach To Licensing Of Fund Managers

## Introduction

The Securities and Futures Commission (the **SFC**) published a circular on 11 June 2007 (the **Circular**) setting out initiatives for simplifying and streamlining its licensing process for fund managers. These represent the first phase of the SFC's streamlining of its licensing processes for all types of intermediaries.

The initiatives set out in the Circular are directed primarily at overseas hedge fund managers. However, the SFC states in the Circular that it intends to apply similar principles to the licensing of fund managers generally where they will only be serving professional investors and it is warranted by the circumstances of the particular case.

The initiatives outlined in the Circular came into effect on 11 June.

The purpose of this note is to summarise the new initiatives. A copy of the Circular is available on the SFC website at [www.sfc.hk](http://www.sfc.hk/).

## 1. Streamlined Licensing Process For UK Or US Licensed/Registered Hedge Fund Managers

An expedited licensing process will apply to firms that are already licensed or registered by the US SEC or the UK FSA as investment managers or advisers if they have a good compliance track record and serve only professional investors (or have parent companies that satisfy the first two of these requirements). Significantly, "professional investors" for these purposes are professional investors as defined in Schedule 1 to the Securities and Futures Ordinance (the **SFO**) and the additional categories of professionals prescribed by the Securities and Futures (Professional Investor) Rules. High net worth individuals (i.e. individuals with a portfolio of at least HK$8 million) and large corporate investors (i.e. companies with a portfolio of HK$8 million or total assets of HK$40 million) are therefore included in the definition of "professional investors" for these purposes.

On submission to the SFC of a set of completed licence application forms relevant to a firm's intended business activities in Hong Kong, the SFC will commence a streamlined review process focusing on key areas of operations such as risk management, valuation, internal controls and management of conflicts of interest.

Firms that are not licensed or registered in the US or UK as investment managers or advisers, but which have proven track records (or have parent companies with proven track records), may also benefit from the streamlined review process.

All licensing applications are considered by the SFC on a case-by-case basis.

## 2. Clarification Of Competence Requirements For Responsible Officers

The SFO requires every licensed company to have at least two Responsible Officers (**ROs**) approved by the SFC for each of the regulated activities for which it is licensed. In addition, every executive director of a licensed corporation must be approved by the SFC as a RO and every licensed corporation must have at least one RO who is an executive director. An "executive director" is a director who actively participates in, or who is responsible for directly supervising, the business of a regulated activity for which a corporation is licensed (Section 113 SFO).

The SFC's Guidelines on Competence further require that a RO must have at least 3 years' relevant industry experience over the 6 years immediately preceding the date of his/her application to the SFC for approval as an RO.

To cater for an increasing number of overseas hedge fund managers applying for a licence for Type 9 Regulated Activity (asset management) the SFC has clarified its requirements for ROs of an overseas hedge fund manager applying for a Type 9 licence which are:

1. Physical presence of ROs in Hong Kong

At least one of the ROs must be based in Hong Kong and immediately contactable at all times by the SFC and the hedge fund manager's staff working from its Hong Kong office. If only one RO is based in Hong Kong, he/she must not be subject to the "non-sole" condition, which means that the individual must have industry experience that the SFC considers to be directly relevant to hedge fund management (see further at paragraph (b) below).
2. "Relevant industry experience"

The SFC will recognise a broader range of industry experience as satisfying the relevant industry experience requirement for ROs of hedge fund managers. Experience acquired from asset management, proprietary trading, research, private equity, special situations, and experience in dealing with other alternative investments will be considered as industry experience directly relevant to hedge fund management.

Experience acquired by individuals in sales, marketing or risk management of hedge funds will however be considered as experience indirectly relevant to hedge fund management business. The SFC will therefore only accept individuals with indirectly relevant experience as ROs if a licensing condition known as the "non-sole" condition is imposed at the time of their approval. The imposition of a non-sole condition means that where a RO (without directly relevant industry experience) actively participates in or directly supervises the business for which the firm is licensed, he must do so under the advice of another RO who is not subject to the "non-sole" condition.
3. Exemption from the local regulatory examination

An individual may be exempted from meeting the local regulatory examination requirement for ROs if the following conditions are met:
	* the person has over 8 years of industry experience in recognised markets (i.e. Specified Futures and Stock Exchanges identified in Parts 2 and 3 of Schedule 1 of the SFO). Alternatively, the person must already be registered or licensed in the UK or US for investment management or advisory business;
	* the firm serves only professional investors (see above);
	* the firm is able to confirm that regulatory and compliance support will be provided to the person; and
	* the person takes a post-licensing refresher course on local regulations.

## 3. Exemption From Licensing Requirement For Providing Intra-Group Investment Advice

The Circular reminds overseas hedge funds that the SFO exempts Hong Kong based firms from being licensed where they merely provide research to their group companies outside Hong Kong. Some overseas hedge fund managers only wish to set up an investment research operation in Hong Kong, to provide research on securities in Asia to their group companies outside Hong Kong.

A firm may be exempt (under the SFO) from the obligation to be licensed to carry on business in Type 4 (advising on securities) and/or Type 5 Regulated Activity (advising on futures contracts) if it is only advising on securities and/or futures contracts to any of its wholly owned subsidiaries, its holding company that wholly owns the firm or other wholly owned subsidiaries of that holding company ("group companies").

The SFC will normally regard an overseas hedge fund manager as being able to rely on this exemption if its Hong Kong office only provides investment advice/research reports to its group companies outside Hong Kong. However, the group companies must assess the advice or reports before issuing any of the material to clients in their own name.

Where a hedge fund manager sends out research analysis and/or provides investment advice to external clients, it may be required to obtain a licence to carry on business in Type 4 or 5 Regulated Activity. Hedge fund managers that carry on the business of portfolio management of securities and/or futures contracts in Hong Kong must obtain a licence to carry on business in Type 9 Regulated Activity.

## 4. Pre-Licence Assistance

Fund managers and professionals may meet with the SFC's licensing staff before submitting a licence application for guidance in simplifying and accelerating the subsequent licensing process.

## 5. Office Space

The SFC does not specifically prescribe the type of office space that hedge fund managers may occupy and they make no distinction between business centres or serviced offices and other types of business accommodation.

Licensed firms may choose their preferred business premises and should ensure that their business premises are, at all times, suitable for the purposes for which they are being used. In particular, firms must satisfy themselves that the business premises occupied by them are appropriately secure and that confidential/non-public information (such as price sensitive information) and client privacy will be sufficiently safeguarded against unauthorised access or leakage.

Further guidance as to the suitability of business premises is available in the FAQs posted on the SFC website.

This note is intended as a summary only of the initiatives set out in the SFC's circular of 11 June 2007. It does not constitute legal advice and specific advice should be sought in relation to any particular situation.

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