
REGULATORY NEWSLETTER

2020 Vol. 2



REGULATORY UPDATES

Circular on the licensing obligations of family offices

7 Jan 2020

The Securities and Futures Commission (SFC) has issued guidance on the licensing requirements for family offices intending to carry out asset management or other services in Hong Kong. As an international financial centre and asset management hub, Hong Kong is an obvious choice for family offices, which are typically set up to manage the financial affairs of high net worth families. Their activities include asset management and estate planning. They may serve a single family or multiple families which are not necessarily connected to each other.

General licensing requirements

In Hong Kong, there is no specific licensing regime for family offices. The licensing regime under the Securities and Futures Ordinance (SFO) is activity-based. If the services provided by a family office do not constitute any regulated activity or they fall within any of the available carve-outs, the family office is not required to be licensed under the SFO. However, family offices should take care not to hold themselves out as carrying on a business in a regulated activity without a licence.

As discussed below, a company or family office set up as a business to manage assets which include securities or futures contracts may be required to hold a licence for Type 9 regulated activity (asset management). The licensing implications of providing asset management services in Hong Kong do not hinge on whether clients are families. Therefore, the relationships amongst the beneficiaries of a family trust or between family members are not relevant in determining whether a licence is

required. For example, a family office can manage assets for persons who are not strictly “family members” (e.g. ex-spouses and in-laws).

If a family office intends to provide other services such as acquiring financial assets following instructions made by the family, it should review whether they fall within the definition of any of the other types of regulated activities such as Type 1 (dealing in securities) and whether it is required to be licensed for them.

Single family offices

The way in which a single family office operates can lead to different consequences under the licensing regime. For example, in cases where a family appoints a trustee to hold its assets of a family trust, and the trustee operates a family office as an internal unit to manage the trust assets, the family office will not need a licence because it will not be providing asset management services to a third party.

Similarly, if the family office is established as a separate legal entity which is wholly owned by a trustee or a company that holds the assets of the family, it will not need a licence as it will qualify for the intra-group carve-out as full discretionary investment manager of the securities or futures contracts portfolio. The family office is not required to be licensed for Type 9 regulated activity if it provides asset management services solely to related entities, which are defined as its wholly-owned subsidiaries, its holding company which holds all its issued shares or that holding company’s other wholly-owned subsidiaries.

Multi-family offices

A multi-family office by definition serves more than one high net worth family. The type of SFC licence required depends on the services to be provided in Hong Kong. If a multi-family office provides services to clients who are not related entities as defined above, it will not be able to make use of the intra-group carve-out.

Where a multi-family office is granted full discretionary investment authority, its asset management activity would generally be similar to that of a licensed asset management company and therefore it would likely need to be licensed for Type 9 regulated activity. If it has not been delegated full discretionary investment authority and only provides securities investment advice and executes securities transactions, it may need to be licensed for other types of regulated activities, ie, Type 1 regulated activity and Type 4 regulated activity (advising on securities). Where the assets include futures contracts, it may also need to be licensed for Type 2 regulated activity (dealing in futures contracts) and Type 5 regulated activity (advising on futures contracts).

If you need any further guidance, please contact enquiry.familyoffice@sfc.hk or any of our consultants.

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Circular to private equity firms seeking to be licensed

7 Jan 2020

The SFC issued a circular that provides general guidance for private equity (PE) firms seeking to be licensed by the Securities and Futures Commission (SFC) to carry on a business of regulated activities in Hong Kong under Part V of the Securities and Futures Ordinance (SFO).

The SFC's Licensing Handbook published in February 2019 states that a PE firm may be required to be licensed for one or more types of regulated activities depending on the types of business it conducts in Hong Kong. In response to recent queries, the SFC is now providing additional guidance on the following:

- A. Licensing requirements for general partners (GPs)
- B. Discretionary investment authority
- C. Investment committee members
- D. Investments in securities of private companies
- E. Offering co-investment opportunities
- F. Fund marketing activities
- G. Industry experience requirement for responsible officers (ROs)

- A. Licensing requirements for general partners (GPs)

It is common for a PE fund to be constituted in the form of a limited partnership. Under this arrangement, a GP assumes ultimate responsibility for the management and control of the fund. In return, the GP would receive management fees, carried interest or other remuneration. In light of the GP's crucial role in managing the PE fund, it is generally required to be licensed for Type 9 regulated activity (RA9) if it conducts fund management business in Hong Kong, provided that the related fund management activities fall under the definition of "asset management" in the SFO. Individuals who perform asset management activities for the GP in Hong Kong are also required to be licensed as representatives and, where appropriate, be approved as ROs accredited to the GP.

However, GPs themselves would not need to be licensed for RA9 if they have fully delegated all of the asset management functions to another entity which is licensed or registered to carry on such regulated activity.

Section 114 of the SFO also prohibits any unlicensed person from holding himself out as carrying on a business in a regulated activity. In particular, an unlicensed GP should not represent to any prospective investor that it manages a PE fund in Hong Kong.

B. Discretionary investment authority

To differentiate RA9 from the regulated activities of advising on securities or futures contracts, the SFC takes the view that licensed asset managers must be granted full discretionary investment authority in respect of the funds they manage. When considering whether a PE firm has this authority, the SFC will look at the facts of each case, including the proposed investment decision-making process, the roles of the proposed licensed individuals (including the ROs) and their involvement in the process, and whether the delegation of investment authority to the firm is properly documented.

For example, the SFC may regard a PE firm as having discretionary investment authority if it proposes to have an RO with sufficient authority and seniority to make investment decisions throughout the life cycle of each fund.

C. Investment committee members

Some PE firms licensed for RA9 have established investment committees in Hong Kong for the funds they manage. Generally speaking, members of an investment committee who, either individually or jointly, play a dominant role in making investment decisions for the funds are required to be licensed as representatives and, where appropriate, be approved as ROs.

Certain investment committee members do not have any voting right or veto power for investment decisions and their primary role is to provide input from a legal, compliance or internal control perspective. These members would generally not need to be licensed.

D. Investments in securities of private companies

Under Part 2, Schedule 5 to the SFO, "asset management" refers to, amongst other things, the provision of a service of managing a portfolio of securities or futures contracts for another person. The term "securities" is given a wide definition in Schedule 1 to the SFO. However, amongst other exclusions, the shares or debentures of a company that is a private company within the meaning of section 11 of the Companies Ordinance (Cap. 622) (CO) are carved out from the definition.

Many PE funds set up special purpose vehicles (SPVs), incorporated locally or overseas, for investment holding purposes. In determining whether an investment portfolio of a PE fund comprises securities or futures contracts for the purposes of RA9, the SFC will consider the composition of the entire investment portfolio. If underlying investments held through SPVs fall within the definition of "securities" (even if the SPVs are carved out) or the SPVs themselves fall within the definition of

“securities”, the SFC will regard the management of the portfolio as “asset management” and the PE firm would be required to be licensed for RA9.

E. Offering co-investment opportunities

If a PE firm offers investment opportunities to other persons whereby they may enter into securities transactions alongside the PE fund, the firm is generally required to be licensed for Type 1 regulated activity (RA1). This is because the act of offering the co-investment opportunities will likely be regarded as inducing other persons to enter into securities transactions.

Nonetheless, the PE firm may not need to be licensed for RA1 if it is licensed for RA9 to manage the PE fund and its act of offering the co-investment opportunities is conducted solely for the purposes of carrying on RA9. For example, if offering co-investment opportunities forms an integral part of fundraising by the PE fund to secure capital to invest in its underlying projects, the PE firm would not be required to be licensed for RA1.

F. Fund marketing activities

As fund marketing activities generally constitute “dealing in securities” as defined in the SFO, a PE firm carrying on a business in such activities would generally be required to be licensed for RA1. However, the licensing exemption discussed in Part E may also apply, where a PE firm which is already licensed for RA9 may market its funds without being additionally licensed for RA1, provided that the related fund marketing activities are conducted by the PE firm solely for the purposes of carrying on RA9.

G. Industry experience requirement for responsible officers (ROs)

In assessing whether an RO applicant of a PE firm has the required relevant industry experience to satisfy competence requirements, the SFC adopts a pragmatic approach and recognises a broad range of experience as long as the applicant can demonstrate that it is relevant to his or her proposed duties. For example, the SFC will consider experience in:

- conducting research, valuation and due diligence of companies in related industries;
- providing management consulting and business strategy advice to companies in related industries;
- managing and monitoring a PE fund’s underlying investments for the best interests of fund investors; and
- structuring corporate transactions, such as management buyouts and privatisations.

The SFC also accepts PE experience gained in a non-regulated situation. It will take into account experience in an overseas jurisdiction where the related PE activities are not regulated, as well as relevant experience in a PE firm which operates in Hong Kong and is exempted from the licensing

requirement. For example, such experience may involve conducting research in Hong Kong solely for use by the PE firm's holding company.

If you need any further guidance, please contact enquiry.pefirm@sfc.hk or any of our consultants.

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ENFORCEMENT NEWS

SFC lifts suspension of UBS Securities Hong Kong Limited acting as sponsor

The SFC lifted the suspension of UBS Securities Hong Kong Limited (UBS Securities Hong Kong) to act as a sponsor for listing applications on the Stock Exchange of Hong Kong Limited (SEHK).

The licence, which allows UBS Securities Hong Kong to act as a sponsor, was suspended for one year as part of the SFC's disciplinary action against UBS AG and UBS Securities Hong Kong (collectively, UBS) when they were sanctioned on 14 March 2019 for their failures to discharge their obligations as one of the joint sponsors of three listing applications.

As agreed, UBS has engaged and cooperated with an independent reviewer to review its policies, procedures and practices in relation to the conduct of its sponsorship business (relevant area).

The reviewer conducted a 10-month review of UBS's enhanced governance processes from the acceptance of a sponsorship mandate to the listing of a listing applicant and concluded that UBS's governance and control processes applicable to the relevant area are generally well-designed, and that its assessment took account of a number of key controls, including:

- a framework of processes, reviews, governance and oversight within the first line of defense to support the transaction team's compliance in the relevant area and to enable effective management oversight;
- policies setting out specific responsibilities for dedicated first line of defense control functions of the sponsor business with respect to quality assurance, control monitoring and testing, as well as issue reporting and escalation, to ensure compliance with internal and regulatory requirements and expectations in the execution of listings;
- adequate and appropriate forums for escalation of material issues identified across the entire deal cycle for discussion with management senior to the sponsor principal (including managers-in-charge) on a specific mandate;

- adequate involvement of the independent second line of defence, ie, the compliance and operational risk functions; and
- an audit programme designed and executed by internal audit as the third line of defense, which is adequate to sufficiently discharge their responsibility and perform annual assessments to ensure that both UBS and its systems and controls remain effective and compliant with the relevant regulatory requirements.

As part of the review, the reviewer also looked at UBS's sponsor work in its two most recent listing applications, which were completed in 2017 and 2018, respectively. UBS was found to have implemented the abovementioned controls in the two listing applications and performed adequate and effective due diligence in discharging its sponsor responsibilities as required by the relevant legal and regulatory requirements.

In arriving at the decision to lift the suspension, the SFC has assessed the reviewer's findings of UBS, including obtaining from the reviewer the supporting documents for its findings, as well as seeking from the reviewer explanations for its conclusions about the adequacy and effectiveness of UBS's governance framework and control processes.

The SFC would like to make clear that the standards assessed in the case of UBS are equivalent to those that are expected to be adopted by all licensed sponsors. In addition, it is important that all licensed sponsors understand that regulatory compliance ultimately depends on the ability of a firm to apply and operate these controls effectively in practice when executing all IPO mandates, which requires close management attention and supervision.

The SFC is satisfied after its own assessment that UBS has clear requirements and procedures in place to enable staff members to understand and properly perform their responsibilities, and that there are adequate and effective systems, controls, policies and procedures to enable compliance with all applicable Hong Kong legal and regulatory requirements in relation to its sponsor business.

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