Comparing Hong Kong's Open-ended Fund Companies with Limited Partnership Funds

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The Hong Kong Government has implemented tax incentives and established regimes for re-domiciling overseas funds to Hong Kong. These moves make Hong Kong a more attractive place for setting up and managing funds.

In this article, we will discuss the main differences between the two investment fund structures in Hong Kong, namely, open-ended fund company ("**OFC**") and limited partnership fund ("**LPF**").

Strengths of an OFC and an LPF

The choice between an OFC and an LPF depends on various factors including market practice, manager's preference, background of investors and their familiarity with the structure, regulatory considerations, nature of the fund, investment scope, and tax incentives.

In general, an OFC can be established as an open-ended fund or a closed-ended fund, a standalone fund or an umbrella structure with multiple sub-funds, and a public or private fund. The following are some of the key strengths of an OFC:

- It is a corporate structure with separate legal personality and limited liability.
- Shares in the OFC may be created or cancelled to meet shareholder subscriptions and redemption requests. Such flexibility is not available to conventional companies incorporated in Hong Kong.
- The law recognizes that the assets/liabilities in each sub-fund can be segregated from the assets/liabilities of other sub-funds, thus allowing greater flexibility in investment strategies.
- Assets are entrusted to a custodian for safekeeping.
- Private OFCs are not subject to investment restrictions.
- Distribution of assets out of share capital is permissible provided the statutory

solvency and disclosure requirements are met.

An LPF is a fund that is structured in a limited partnership form and does not have a legal personality. The founder/promoter is a key operator, takes the role of the general partner ("**GP**") and has unlimited liability. Investors are limited partners ("**LPs**") and enjoy limited liability up to the amount of their agreed contributions. The structure is used for the purpose of managing assets for investors as LPs and is a popular form of private equity and venture capital funds. The key strengths of an LFP include:

- It allows flexibility in the limited partnership agreement between the GP and LPs, subject to certain basic statutory requirements, e.g. the LPs cannot take part in the management of the LPF.
- LPFs are not subject to investment restrictions.
- Its establishment does not require approval from the Securities and Futures Commission of Hong Kong ("**SFC**").
- There is no minimum capital requirement on partners.
- No Hong Kong stamp duty is imposed on any contribution or withdrawal by any partner or on any transfer of partnership interest.

Key Operators

One main difference between the two structures is that the establishment of an OFC requires SFC's approval. The SFC adopts a one-stop process for approving an OFC, i.e. the applicant only needs to submit an application to the SFC which will then liaise with the Companies Registry of Hong Kong.

Provided the legal requirements are met, an LPF can be registered with the Companies Registry. SFC approval is not required for setting up an LPF.

This different registration process is mainly due to the more stringent legal requirements on the operators of OFCs, such as:

- An OFC must have at least two natural person directors of at least 18 years of age. More importantly, the directors are subject to approval by the SFC and must be of good repute and have the technical knowledge, ability and expertise to carry out the business of the OFC.

  The GP of an LPF may be a natural person who is at least 18 years old, a private Hong Kong company limited by shares, a registered non-Hong Kong company, a Hong Kong registered limited partnership, another LPF, or a non-Hong Kong limited partnership without legal personality. The law does not impose the knowledge and expertise requirements on GPs, as in the case of OFC directors. Nevertheless, an LPF must have a responsible person to carry out anti-money laundering measures.
- The investment management function of an OFC must be delegated to an investment manager which must be licensed or registered with the SFC for carrying out Type 9 (asset management) regulated activity and remain fit and proper, at and after registration of the OFC.

The LPF is required to appoint the GP or another person as its investment manager to carry out the day-to-day investment management functions of the LPF. The investment manager can be a Hong Kong resident, a Hong Kong company, or a registered non-Hong Kong company. It is not required to be licensed or registered with the SFC unless it conducts regulated activities in Hong Kong.

- It is mandatory for OFC to appoint a custodian for safekeeping the investment property. The custodian must satisfy the eligibility requirements under the Code on Unit Trusts and Mutual Funds of the SFC, or must be licensed or registered with the SFC for carrying out Type 1 (dealing in securities) regulated activity.

  There is no requirement for an LPF to have a custodian, but the GP should ensure the proper custody of the LPF's assets.

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