

# Private Closed-ended Funds in Hong Kong – An Overview



**Tiang & Partners**  
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# 01

## Our strengths



## Tiang & Partners' Funds practice

Tiang & Partners is an independent Hong Kong law firm that collaborates closely with PricewaterhouseCoopers Limited (“**PwC**”). The Funds and Regulatory practice consists of two partners and a team of dedicated investment funds and regulatory lawyers and legal staff covering the entire spectrum of investment funds, from private equity, hedge, hybrid to retail and authorised funds, and all non-contentious regulatory issues related to investment management activity in Hong Kong.

We have the capability and experience to advise on the full range of private funds including those which invest in:

- Private equity (including venture/clean tech., expansion capital, buyout and special situations)
- Natural resources (including clean energy)
- Credit
- Infrastructure
- Real estate
- Mezzanine
- Debt
- Distressed assets
- Secondaries
- Agriculture
- Fund of funds

We can advise both managers and investors on the full range of legal issues associated with closed-ended funds, including:

- Fund formation and documentation including appointment of advisers/ service providers, structuring, advice on terms, marketing, documentation, investor negotiations and ongoing support following closing
- Regulatory issues including authorisation, ongoing compliance and marketing restrictions
- Fund manager establishment including structuring tax efficiency and documentation (such as LLP deeds and shareholder agreements)
- Taxation for funds, managers and transactions (through our PwC network)
- Team incentive schemes (including carried interest and co-investment schemes)
- Investments in private funds
- Secondaries
- Transactions including private equity (“**PE**”), mergers and acquisitions (“**M&A**”) and special situation investments
- Financing and loan structuring for private funds that employ leveraged strategies
- Employment including contentious and non-contentious matters
- Restructuring and insolvency advice
- Virtual assets, security tokens and all forms of cryptocurrency

Our lawyers work closely with PwC’s Asset & Wealth Management and Financial Services Lines of Service, as well as the global Legal teams within the PwC legal network, to provide integrated advice and support on operational, regulatory, and transactional aspects to fund managers, sponsors and investors. Our in-depth industry knowledge and expertise in specialist areas also equips us to advise on the full range of issues relevant to hedge, private equity, crypto and hybrid funds and their managers.

Given this capability, we are able to provide an end-to-end solution across the entire life cycle of a fund, from inception, to operation, through to termination. In addition, drawing from expertise across the entire legal and wider PwC network, we are able to provide services across all aspects of a fund's operation and in relation to asset management activity generally.

## **Tiang & Partners is a full-service asset management law firm**

### **Transactional capabilities**

Our experienced team understands the importance of delivering value at all stages of a client's transaction and that the success of the deal usually comes from unlocking the value of a target post-completion.

Our unique end-to-end approach sees our lawyers working closely with PwC's consultants, commercial advisers, tax advisers, accountants, strategists and actuaries to help our clients execute every phase of the deal in the most efficient way possible. We provide support on:

- Mergers and acquisitions
- Business set up
- Structuring
- International business reorganisation
- Joint venture projects
- Other corporate services

For PE fund managers, therefore, this means that we have the capabilities to assist with the "downstream" aspects of a PE fund's operations – namely the deployment of capital, and the acquisition and development of portfolio assets including real estate development projects, corporate acquisitions and joint ventures, mergers, share transfers and divestments, trade sales, and IPOs.

Our corporate team is also able to assist fund managers in relation to their management structure, including shareholder arrangements, seeding arrangements and revenue share structuring for general partners, management companies, special limited partners, or holding structures that sit above the management structure for a PE fund.

### **Finance capabilities**

With rich experience in banking and finance transactions, our team executes deals across borders to achieve finance solutions for clients in Asia Pacific.

Our team has acted for a wide array of clients including investment and commercial banks, financial institutions, corporate entities and investment funds in various industry sectors. Our team also has in-house experience within major banks and financial institutions – which means we understand your challenges and requirements, guiding you through all stages of the project, from decision making to implementation.

With access to the PwC network, we can offer a holistic view on your projects and investments with PwC professionals from tax, deals, financial due diligence, assurance and consulting, where needed.

For funds and fund managers in particular, our finance team is able to assist on all aspects of fund lending and borrowing transactions, including note issuances, fund financing, mezzanine financing, GP or LP interest collateralisation and note and debt participation programmes (for private credit funds in particular). In addition, our team has experience with all types of structured product arrangements including total return swaps, options and futures contract drafting.

**Structuring of investments** – We have access to legal, tax and sector professionals across the PwC network who will advise on the optimal tax efficient deal structure or platform for each investment.

**Best in class advisers** – The integrated offer available through the PwC network means you will have access to multidisciplinary due diligence reports which cover legal, tax and financial considerations, helping you solve the whole of your problem, not just part of it.

**Support at financial close** – We will leverage the breadth of the PwC network, including highly experienced finance and restructuring lawyers with decades of experience working in Asia, to manage and deliver the legal agreements, opinions and process management required and assist you in the effective and timely execution and closing of your deals.

**Support post financial close** – We are available to support your continued success by assisting with ongoing contract interpretation and management, as well as the provision of further legal updates and input during the post-closing phase.

## Employment capabilities

### How can we help

- Assisting clients in managing risks and designing practical solutions in relation to hiring/onboarding process, contract termination/expiration, global mobility, restructuring, incentive and bonus schemes, compliance investigations and other challenging objectives in daily human resource management, especially for employment arrangements and professional in the asset management and investment funds field.
- Devising people and organisation plans, implementing projects and resolving different types of labour disputes, including commercial controversies relating to violation of anti-unfair competition or non-compete obligations, highly contentious executive exits, collective bargaining, and redundancy, etc.
- Handling redundancies, transfers and layoffs in association with M&A deals, cross-border restructuring, entity winding up/business closure and relocation, and we collaborate closely with other members of the PwC global network of firms in addressing other commercial and human resourcing affairs of significant projects.
- Providing the full spectrum of labour and employment services. Our team includes experts who previously worked in the Ministry of Labour and contributed to the legislation of PRC Labour Law, and lawyers who have decade-long experience and expertise in various labour and employment matters.

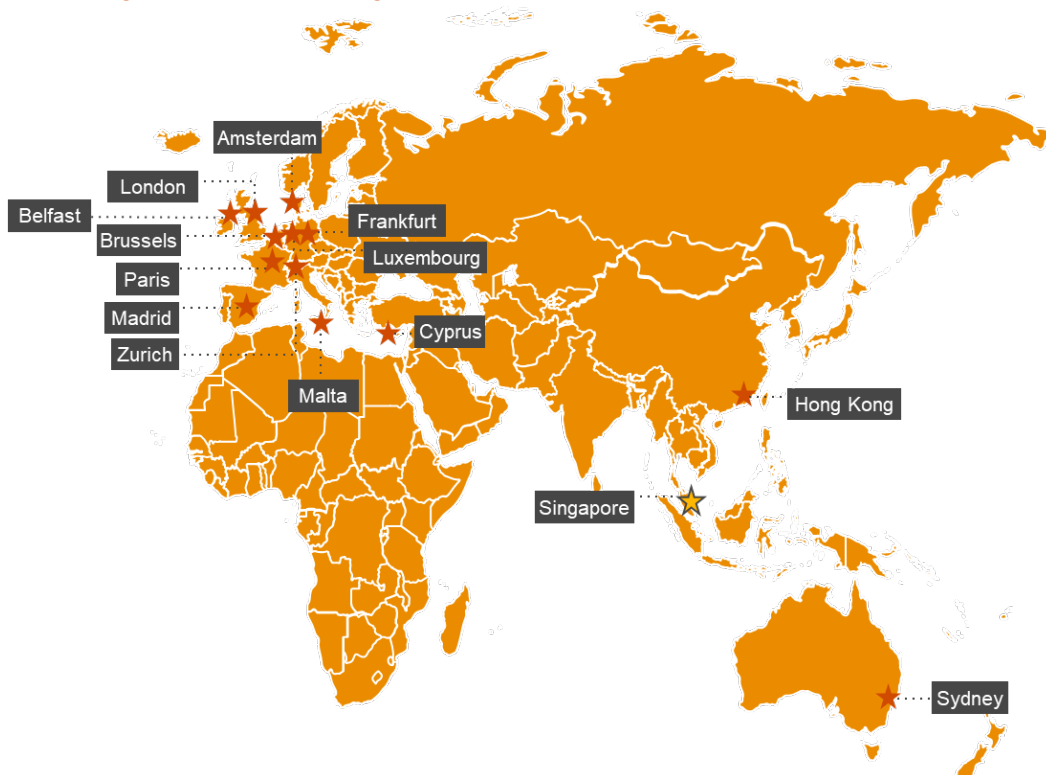
- Setting up employment incentive plans, carry pool plans and bonus plans for sharing carried interest, management fees and performance fees with investment staff or for principals of a fund manager.
- With the current economic and market dynamic and the emergence of new technologies, we stand with our clients ranging from start-ups to the largest and most reputable multinational companies to face the greater-than-ever PRC employment and human resource challenges. Against this backdrop, we work seamlessly with PwC's other member firms to provide a "one-stop" service and commercially focused solutions.

### The PwC Global Legal Practice

The PwC global legal services network connects the expertise of over 3,700 legal professionals in nearly 100 territories, bringing the right combination of legal insight, business understanding and technological innovation to transform how you work and make the right decisions.

Investments funds and regulations need global perspective with local knowledge. The PwC global legal Funds team has presence in many of the key jurisdictions in which funds clients invest in, and has established alliances with leading law firms in many other jurisdictions. Working with us is not just about legal advice – by collaborating closely with PwC's Tax, Assurance, Risk and Regulatory Compliance, Deals and Crypto Advisory teams, our team provides asset and wealth management clients with an integrated, end-to-end business solution to all of their asset management and investment fund needs.

#### Funds legal services coverage:





# 02

## Private equity funds in Hong Kong – an overview





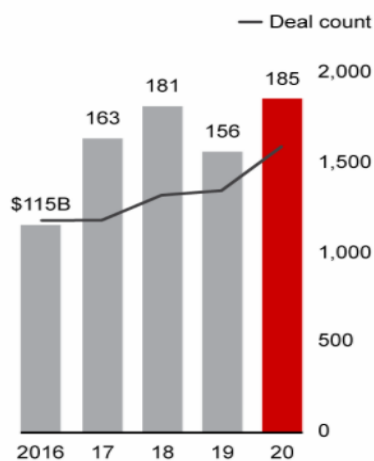
## 1. Introduction

Along with the region, the private equity industry in Hong Kong has seen tremendous growth in recent years. As shown in the figures published by the Asia Venture Capital Journal, Hong Kong is the second-largest private equity hub in Asia-Pacific after Mainland China, with total capital under management at US\$162 billion as of 2019. Asia-Pacific private equity deal value rose to US\$185 billion in 2020, and was 20% greater than the 2016-19 average. The investors in private equity deals come from various sectors, including pension funds, insurance companies, sovereign wealth funds and family offices. There was also continuous growth in the total number of private equity and venture capital firms in Hong Kong and the number of PE/VC firms reached 581 in 2020.

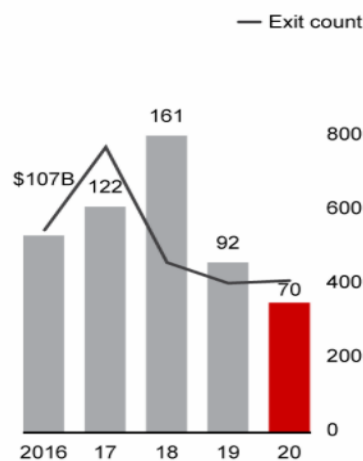
Parallel to the increase in private equity deals volume in Hong Kong, the type of fund structures available to fund managers and the funds regulatory landscape in Hong Kong has also continued to evolve.

### Asia-Pacific PE Industry

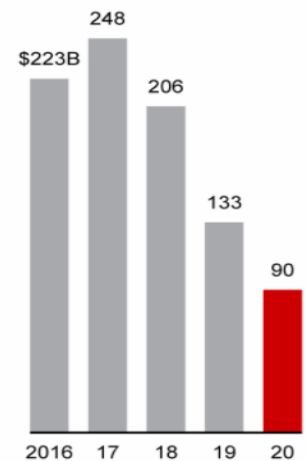
Asia-Pacific private equity investment value (\$B)



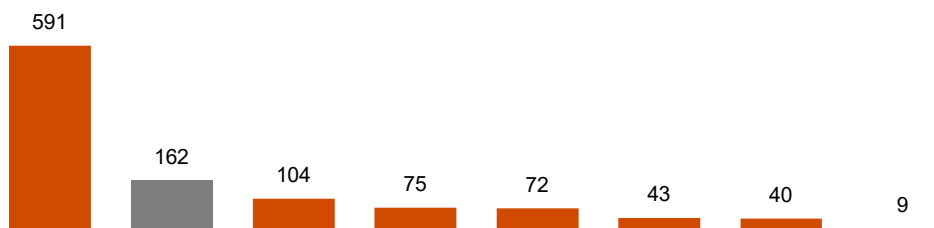
Asia-Pacific private equity exit value (\$B)

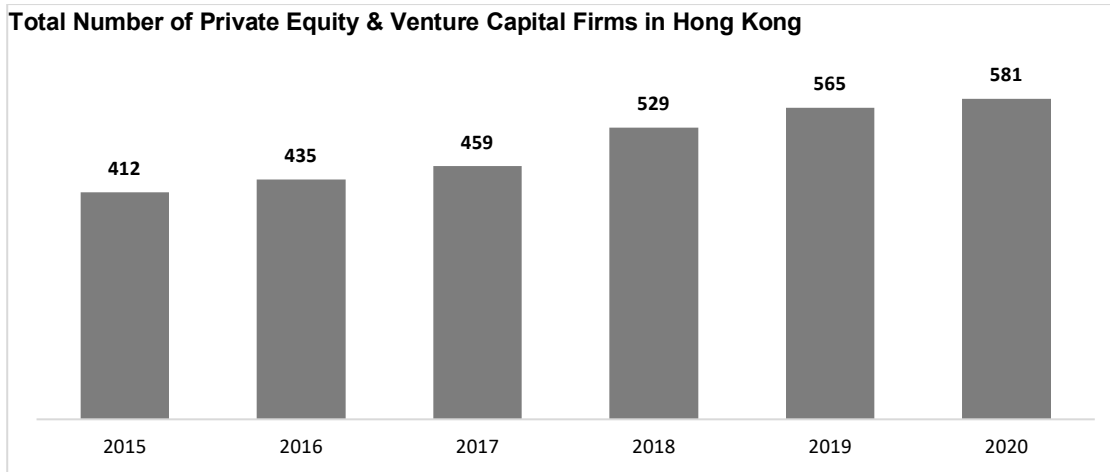


Asia-Pacific-focused closed funds, by close year (\$B)



Private Equity Capital Under Management (US\$ billion)



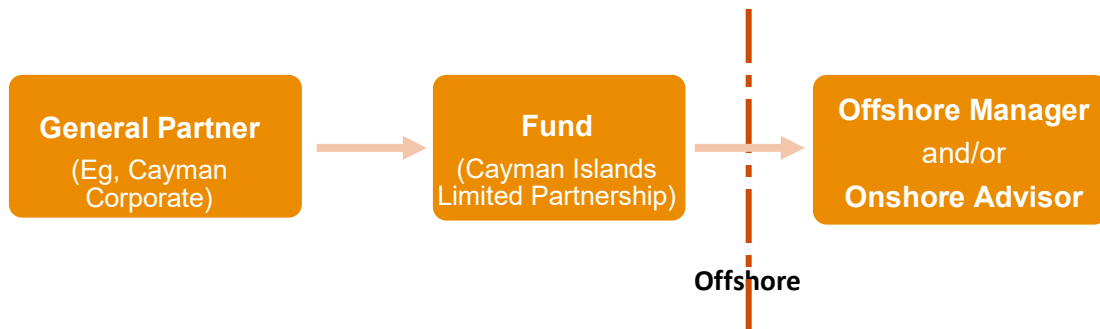


Source: Asia Venture Capital Journal, Preqin

### Typical fund structures

- In Hong Kong, the majority of PE investment vehicles used by fund managers are limited partnerships established in the Cayman Islands. A fund may be domiciled in Hong Kong, Singapore, US, UK, Guernsey, Jersey, Luxembourg, the Cayman Islands, or Mauritius. Onshore funds generally cost less to set up and maintain.
- Typically, in an offshore limited partnership fund structure, an offshore limited liability company owned by the principals/sponsors of the fund, acts as the general partner (“GP”).
- In the past, it was common for such limited partnership to enter into a management agreement with another offshore limited liability company that would act as the offshore manager (which was also usually owned by the principals/sponsors of the fund). The offshore manager then entered into an investment management agreement with an investment manager that might hold an SFC licence to carry out asset management activities, or an investment advisory agreement with an investment adviser that may hold an SFC licence to provide investment advice.
- However, nowadays, it is much less common to see Hong Kong managers and sponsors setting up fund structures that involve an offshore manager. Instead, they would have an onshore entity act as the investment manager (and to pay Hong Kong taxes on amounts earned as carry and management fees in Hong Kong). There are 2 main reasons for this:
  - *Tax assessed by “resource allocation*: To determine whether revenues generated from the fund are taxable in Hong Kong, the Hong Kong tax authority looks at where the fund’s management activities take place. If all of the fund’s management activities (covering fund-raising, advisory, administration and discretionary management activities) are taking place in Hong Kong, the Hong Kong tax authority takes the position that all or most of the revenues generated from those activities ought to be paid into Hong Kong (and taxed accordingly), regardless of the management structures that have been set up.

- *Economic substance requirements:* Nowadays, most offshore regulators (including the Cayman Islands since January 2020) require investment management entities established in their jurisdictions to have “economic substance” in their place of incorporation. What this means exactly still remains unclear, but the prevailing view is that at a minimum, the Offshore Manager ought to have a physical office in the relevant jurisdiction, real directors resident in the that jurisdiction need to be appointed, a minimum number of meetings ought to be held annually, and certain statements and reports need to be generated from the relevant jurisdiction. The result, in practical terms, is that there is now an additional cost layer (approximately US\$40-60,000 per annum, depending on the amount of activity that needs to take place for a jurisdiction like the Cayman Islands) if an offshore manager is to be retained in the structure.
- Foreign PE fund managers, however, may prefer to retain carried interest and management fees offshore, in which case, they may only pay advisory fees to a domestic Hong Kong investment advisory entity, and ensure that management of the fund is carried on outside of Hong Kong by the GP.



### Advantages of using a Cayman Islands GP/LP structure

- The Cayman Islands GP/LP structure remains a popular choice for PE funds in this region.
- Familiarity with the structure, especially among US and European investors, means that capital raising is easier.
- Closed-ended funds often invest in illiquid investments, and investor interests are not “unitised” in the way open ended “hedge” funds are (by way of shares). There is (usually) no regular NAV calculated for the fund, and no regular subscriptions or redemptions. Capital commitments are “called” or “drawn” down to make investments during a set period, and on disposal, returns are distributed following a set “waterfall”. Each investor, known as a “limited partner” (“LP”) has its economic interests represented by way of individual partnership accounts, and a “share” in the fund’s economics by way of a partnership interest. This method of accounting provides for a more accurate representation of an investor’s share in the fund’s economics as it allows for a truer apportionment of costs, expenses, revenues, gains and losses.

### Disadvantages of using a Cayman Islands GP/LP structure

- The disadvantage of using a GP/LP structure centres mainly around costs. Because this is essentially a contractual arrangement, many more aspects of the fund’s constitutive documents, including its private placement memorandum (“PPM”) and its limited partnership agreement (“LPA”) are open to negotiation and comment from investors. In addition,

investors may separately negotiate and demand preferential terms by way of side letters. While the documentation costs of a closed-ended fund may be controlled, the final legal costs involved to get the fund to its final close may be several times more than the initial documentation costs.

### New Hong Kong Limited Partnership Fund

- On 9 July 2020, the Legislative Council of Hong Kong (the “**LegCo**”) passed the Limited Partnership Fund Bill, establishing a limited partnership fund (“**LPF**”) regime which enables funds to be constituted and registered in Hong Kong in the form of limited partnerships. The new LPF Ordinance came into effect on 31 August 2020.
- The LPF regime is a registration regime, under which registration is effected through the Companies Registry in Hong Kong. The SFC will not be directly involved. It largely shares the characteristics of a Cayman Islands exempted limited partnership (“**ELP**”) regime, for instance, same as an ELP, an LPF vehicle has no legal personality and is constituted by a limited partnership agreement. Also of note is that an LPF needs to be a “fund”, which is similar to that of a “fund” under the revised Inland Revenue Ordinance (“**IRO**”) and that of a “collective investment scheme” under the SFO. Under the LPF Ordinance, an LPF must have one GP with unlimited liability with respect to the debts and liabilities of the LPF and at least one LP which is not liable for the debts and obligations of the LPF beyond the amount of the partner’s agreed contribution.
- The LPF regime will certainly be attractive to a Hong Kong-based sponsor, given that the centralisation of a fund’s management, operation and domicile will reduce the cost of having to engage additional professionals and service providers for regulatory compliance in multiple jurisdictions (the legal fees and disbursements savings from using an LPF as opposed to a Cayman ELP are not insubstantial). This will be important for managers/sponsors looking to launch smaller sized funds, where Asset Under Management (“**AUM**”) limits will make cost considerations at the forefront of the decision process.
- As far as our practice is concerned, because we are jurisdiction agnostic, we will be able to act as the lead counsel on the establishment of a fund using the LPF structure in the same way as we would for an ELP structure. Our drafting would be largely similar, although there will be bespoke adjustments and fine-tuning needed to ensure compliance with the Hong Kong regime. If using an LPF is of interest, feel free to come speak to us!

### New unified tax exemption regime in Hong Kong for funds

- The IRO was amended from 1 April 2019 to exempt all funds, no matter where established or domiciled, from Hong Kong profits tax arising from qualifying transactions provided that the relevant fund is managed by a specified person (essentially an SFC licensed corporation).
- LPFs can also rely on this tax exemption, in the same way as offshore funds can, in respect of qualifying transactions. For a more detailed discussion of the requirements that need to be met in order to qualify for an exemption under the new unified regime, please consult or seek advice from one of our tax experts within the PwC network.
- Apart from the tax neutrality as outlined above, no stamp duty will be payable on assignment of interests in an LPF under the new regime. Interests in an LPF are not “Hong Kong stock” as defined in the Stamp Duty Ordinance of Hong Kong (Cap. 117) and so, on assignment, should not be chargeable to Hong Kong stamp duty. However, in-kind capital contributions of

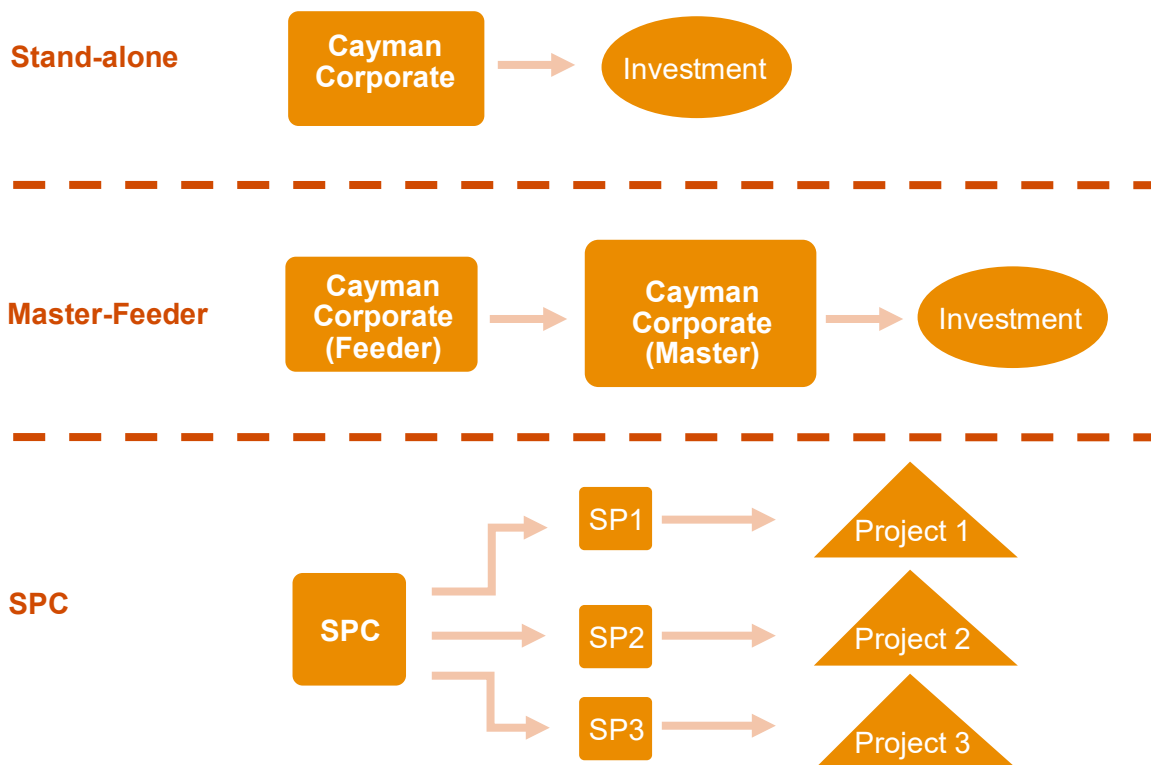
shares or real estate to an LPF or distributions by an LPF of Hong Kong stock are dutiable in the normal way.

### Carried Interest concession regime for PE funds in Hong Kong

- On 28 April 2021, the LegCo passed the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021 to introduce a tax concession regime for eligible carried interest that arises from qualifying PE transactions.
- Under the new carried interest regime, carried interest distributed by eligible PE funds operating in Hong Kong will enjoy a 0% profits tax rate, and there will be an exclusion of 100% of eligible carried interest from employment income for the calculation of salaries tax.
- On 16 July 2021, the Hong Kong Monetary Authority issued a guideline on the certification of funds under Schedule 16D to the IRO in relation to tax concessions for carried interest. The certification scheme is open to application by funds with immediate effect. The main criteria are (i) the fund has invested in certain classes of assets (such as shares or bonds of a private company); and (ii) the qualifying person has satisfied the minimum activity requirements (at least 2 full-time qualified employees who carry out investment management services, and HK\$2 million operating expenditure) throughout the applicable period. A qualifying person will also have to satisfy the “adequacy test” under section 5(3) of Schedule 16D to the IRO in order to be eligible for tax concessions.

### Corporate structures for closed-ended funds

- Corporate structures are popular among PRC managers and institutions, and lately, have become more prevalent for closed-ended funds.
- The Cayman Islands segregated portfolio company (“**SPC**”) is particularly attractive to managers looking to invest in specific projects, be it real estate, infrastructure developments, or pre-IPO investments, because it allows specific projects/developments to be “housed” under a separate segregated portfolio (“**SP**”).
- A Hong Kong Open-ended Fund Company (“**OFC**”) may also be suitable for these purposes, although if an OFC is to be used instead of an SPC, an SFC-licensed manager will need to be appointed to manage the fund in Hong Kong. (For the purposes of the discussion below, references to an “SPC” or a “Cayman Corporate” also include an “OFC” (whether as a stand-alone, master feeder, or umbrella structure) as appropriate).



#### Advantages of the SPC structure

- The SPC allows the issuance of separate share classes in respect of each underlying SP. If a separate project / development is “housed” in each SP, then this allows fund investors to “pick and choose” which projects to participate in, rather than being in a strict blind pool.
- It is much faster and more cost effective (at least from a documentation perspective) to create each new SP as the fund acquires new investments.
- Each SP functions as its own “mini-fund”, which means the SPC as a whole becomes evergreen. Each “mini-fund” theoretically provides the ability to “ring fence” assets and liabilities from all other mini-funds or pools.
- Generally, establishment costs are lower as a corporate structure’s constitutive documents (namely the Memorandum and Articles of Association) are less open to negotiation/amendment (unlike an LPA for a GP/LP structure).

#### Disadvantages of corporate structures for closed-ended funds

- A corporate structure is less suited to concepts that are part of the convention for closed ended funds. For example, capital commitment and drawdown – how would one square this with the issuance of shares? Do you issue shares on a fully paid-up basis and simply have the commitment and drawdown as a contractual obligation that you adjust as you go along, or do you tie share issuance with drawdown (and issue on a partly paid basis)? In addition, how do you deal with shares that have been issued when capital contributions are reduced from a distribution? Do you partially redeem shares?
- In addition, how would the fund manager ensure that costs and expenses are properly distributed among shareholders? With partnership accounts, the mechanism is simple and accurate. With shares (and without the benefit of a regular Net Asset Value (“NAV”)),

however, the drafting has to be left deliberately vague to allow the fund manager to make adjustments by issuing/redeeming shares (or parts thereof).

### The Hybrid Solution

- A “halfway” house that managers may want to consider is to structure the fund as a straightforward corporate vehicle that is open-ended (in the same way hedge funds are structured). There will be open redemptions and subscriptions, a regular NAV, and performance fees and management fees that are determined based on NAV/AUM.
- To match liquidity (between the underlying assets – which are illiquid) and redemption, “hard locks” can be imposed (up to say 4 or 5 years) which would prevent redemption of shares. These can be adjusted from share class to share class, depending on the liquidity characteristics of the underlying investment.
- The advantage of this hybrid approach is that documentation costs are materially reduced. The drafting becomes conceptually more straightforward as there is no need to “cram” PE style concepts into a corporate framework, and overall, the fund is easier to manage and operate as an open-ended vehicle.

## 2. Marketing Restrictions

- Under the SFO, any marketing document that contains offers of investment products to the public of Hong Kong (or any class of the public of Hong Kong) may not be issued, unless either the relevant advertisement (including offering documents) is authorised by the SFC or the offer is made within an exemption set out in the SFO.
- All marketing documents or advertisements (including offering documents) directed at the public of Hong Kong are, as a condition of SFC approval, required to contain adequate and accurate disclosures for investors to make informed decisions. Disclosure standards for offering documents of collective investment schemes are set out in the SFO and the SFC’s Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (the “**SFC Handbook**”). Compliance with the SFC Handbook is a requirement to have an offering document approved by the SFC. In reality, the SFC will not approve any offering document without the fund being authorised under the SFO.

## 3. Licensing – Do I need a Type 9 Licence to manage a PE Fund in Hong Kong?

### Regulated activities

Under the SFO, persons who engage in regulated activities in Hong Kong must be licensed or registered with the SFC. A corporation that carries on a business in a regulated activity or actively markets services to the public which constitute a regulated activity need to be licensed, while individuals performing a regulated function for a licensed corporation must be accredited as a licensed representative and, if the said individual is also an executive director, approved as a responsible officer. Authorised financial institutions that are supervised by the Hong Kong Monetary Authority, such as banks or deposit-taking companies, must also be registered with the SFC to carry on a business involving regulated activities.



Schedule 5 of the SFO sets out 10 categories of regulated activities. These are:

- Type 1 (dealing in securities);
- Type 2 (dealing in futures contracts);
- Type 3 (leveraged foreign exchange trading);
- Type 4 (advising on securities);
- Type 5 (advising on futures contracts);
- Type 6 (advising on corporate finance);
- Type 7 (providing automated trading services);
- Type 8 (securities margin financing);
- Type 9 (asset management); and
- Type 10 (providing credit rating services).

Notwithstanding the wide scope of regulated activities, the licensing position for PE fund managers has traditionally been uncertain. PE funds generally invest directly in assets or indirectly through holding companies, or make direct investments into the private equity of companies through different investment strategies such as venture or growth capital. Managing or advising such funds could arguably fall within the ambit of Type 4 (advising on securities) and Type 9 (asset management) regulated activities if the “portfolio” (owned by the Fund) which a manager/adviser is managing, or advising, is comprised of “securities”.

Clearly, a PE fund which invests directly in assets that do not fall within the definition of “securities” under the SFO (for example, directly in real estate without the use of any special purpose vehicles) would not require its manager/adviser to obtain a Type 9 or Type 4 licence in order to manage or advise it.

The position is less certain, however, when it comes to PE funds that own a portfolio of private company shares (by extension, a PE fund that invests in real estate through a holding of private company shares may also run into issues).

### **Definition of “securities” under the SFO**

Schedule 1 of the SFO provides a wide definition of “securities” which includes, inter alia, shares and debentures issued by any incorporated or unincorporated body. The definition does not, however, include the shares or debentures of private companies within the meaning of section 11 of the Companies Ordinance (Cap. 622). Technically speaking, therefore, only shares in private Hong Kong companies would **not** be considered “securities” under the SFO. This means that if applied strictly, any PE fund that invests in private companies, or through SPVs, that are incorporated in, say, the BVI, Cayman Islands, etc, or that are wholly foreign-owned enterprise (“WFOE”), would technically be investing in a portfolio of securities. Any fund manager that advises or manages that fund in Hong Kong would therefore be carrying out a regulated activity for which a Type 4 and/or Type 9 licence is needed.

Technicality aside, however, the practical reality in Hong Kong, and the prevailing market view, is that any fund that does not invest in or trade public securities is a PE fund that does not need a Type 9 or Type 4 licence to be managed/advised. For the most part, at least up until recently, the SFC's position also appeared to be that it would not look too closely at the issue – for example, in one of the SFC's earlier FAQ on Venture Capital Companies, the SFC stated that dealing in or advising on “private equity” (which does not involve securities) would not, by itself, attract a licensing requirement. However, the definition of “private equity” was left deliberately vague.

### **The New Position**


Pursuant to the guidance under paragraphs 1.4.18 and 1.4.19 in the latest edition of the SFC's Licensing Handbook, however, the SFC has now confirmed that if a firm deals in, advises on, or manages shares or debentures of private offshore companies that fall outside the definition of “private company” under the Companies Ordinance, it is likely that such firm will require a licence for any regulated activities conducted in Hong Kong.

The Licensing Handbook provides further guidance on the type of licence that may be relevant based on the PE firm's business model:

- A firm that is delegated with discretionary power to make investment decisions on securities in Hong Kong for a fund would be required to obtain a licence for Type 9 (asset management) activity;
- A firm that is not granted discretionary investment authority by the fund it serves would need to be licensed for Type 1 (dealing in securities) regulated activity if it markets or distributes a fund or conducts any other securities dealing activities (such as deal negotiation and trade execution) for the fund, or, unless the wholly-owned group company exemption is available, Type 4 (advising on securities) regulated activity if it provides investment advice to the fund.
- A PE firm may also continue to rely on any applicable incidental exemptions, whereby certain regulated activities will not require a licence to be granted by the SFC if such activities are performed wholly incidental to the carrying out of another regulated activity that the firm is already licensed for. The most relevant incidental exemption for PE managers is where the manager is licensed for Type 9 (asset management) regulated activities, it will not require an additional licence to carry out any Type 1 (dealing in securities) or Type 4 (advising on securities) regulated activities provided that these are carried out solely for the purposes of its asset management business.

The latest guidance issued by the SFC represents a significant pivot by the regulator, and signals, in our view, a more rigorous focus on the actual activity that is carried out by PE fund managers in Hong Kong. Gone are the days where a manager in Hong Kong can assume that simply because the fund it is managing is a PE fund, that it will not need any sort of regulatory licence. Instead, managers should now carry out a careful analysis of the actual composition of the fund's portfolio to determine if there are any “securities” within that portfolio.

For many PE funds, the formal investment decision is usually made offshore either by the general partner of the fund (assuming it is structured as a Cayman Islands limited partnership), the Cayman manager (a separate Cayman Islands corporate entity that is usually owned by the fund's sponsors), or an investment committee established by the Cayman manager. In turn, these entities rely on the research, due diligence and contract negotiations conducted by local



onshore staff on behalf of the fund in Hong Kong. While this arrangement should remain unaffected (in terms of whether the domestic entity in Hong Kong would require a Type 9 licence), managers should be careful to ensure that investment decisions and discretion are in fact exercised offshore from Hong Kong, and that there is no management activity taking place in Hong Kong. The SFC will likely examine such arrangements more closely going forward.

For many PE fund managers, the decision of whether to get licensed in Hong Kong comes down to their appetite for reputational/regulatory risk. Increasingly, larger fund houses will seek to get licensed for PE funds in any event, because the reputational risks are too high. With the pivot by the regulators in Hong Kong, it is submitted that this risk has just become even higher across the board for PE fund managers of all sizes.

Regulatory/reputational risks aside, managers should also consider the other costs and benefits of getting licensed. Obviously, having a licence entails the regulatory burden of ongoing compliance (which has become even heavier following the introduction of the revised Fund Managers' Code of Conduct – which applies to PE funds as well as hedge funds). Applying for a licence is also costly and time-consuming (expect up to 6 months now before a licence will be issued).

There are, however, many benefits that come with being licensed. For one, having a Type 9 licence means that the manager can also market the fund in Hong Kong (since a Type 9 licence holder can exercise Type 1 functions as an incidental activity to the management function it is exercising in respect of the fund). This would mean the fund can avoid having to appoint a separate placement agent, and hence save on placement/distribution fees. Being regulated by the SFC may also aid with capital raising since the SFC is a well-regarded regulatory authority in the region.



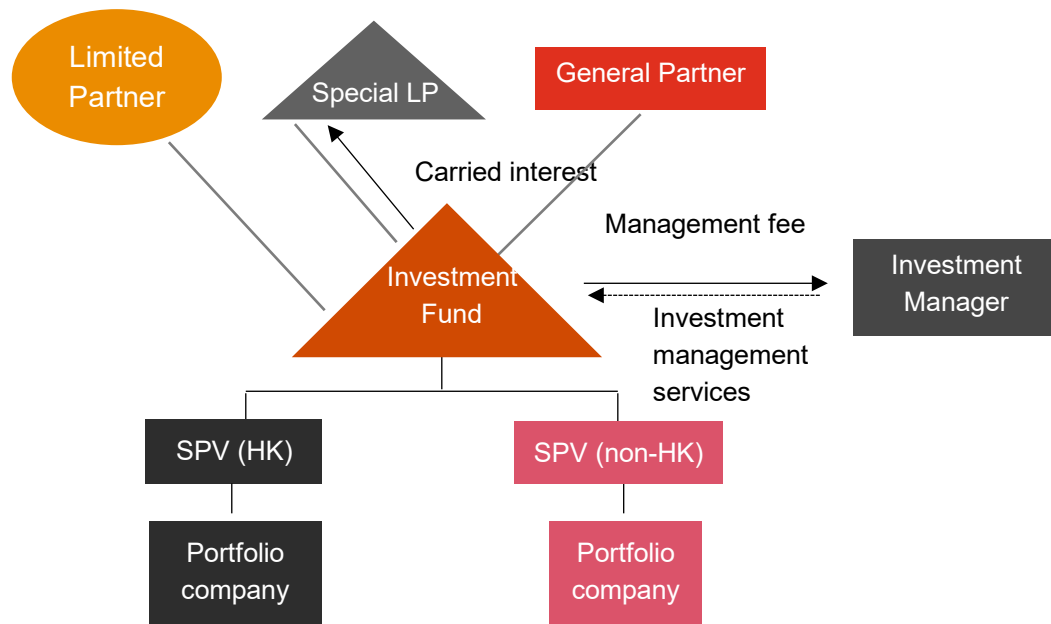
# 03

## Tax and structuring considerations



## Investment Fund level

Typical private equity/ venture capital fund structure



Typical private equity fund locations adopted by asset managers in the region (for raising onshore and offshore funds)

- Cayman Islands
- Singapore
- Others (BVI, Bermuda – less common)
- Hong Kong (the rising new fund hub)

Typical (cross-border) private equity investment fund vehicles (non-exhaustive)

Cayman Islands	Singapore	Hong Kong	Mainland China (for reference)
<ul style="list-style-type: none"> <li>▪ Exempted Limited Partnership</li> <li>▪ Exempted Company</li> <li>▪ Segregated Portfolio Company</li> <li>▪ Limited Liability Company</li> <li>▪ Orphan Trust</li> </ul>	<ul style="list-style-type: none"> <li>• Variable Capital Company (VCC)</li> <li>• Limited Partnership</li> <li>• Limited Private Company</li> </ul>	<ul style="list-style-type: none"> <li>• Open-ended Fund Company</li> <li>• Limited Partnership Fund (new)</li> </ul>	<ul style="list-style-type: none"> <li>• Foreign Direct Investment</li> <li>• Qualified Foreign Limited Partnership (QFLP)</li> <li>• Foreign Invested Venture Capital</li> <li>• WFOE in FTZ</li> <li>• China Holding Company (CHC)</li> </ul>

## Typical (cross-border) private equity investment fund vehicles – A comparison

Location	Comments
Cayman Islands	<ul style="list-style-type: none"> <li>• Most common fund location; Tax neutral jurisdiction</li> </ul>
Singapore	<ul style="list-style-type: none"> <li>• Variable Capital Company (“<b>VCC</b>”): A new regime rolled out in 2019; Tax exemption available (with conditions) and would be suitable for a private equity fund vehicle; The regime is relatively new (there are 20 pilot cases based on our understanding);</li> <li>• Singapore limited partnership: tried and tested; tax exemption available provided there is a qualified investment manager and other conditions are fulfilled;</li> <li>• Singapore private company: used by some funds, easy to set up but are subject to normal corporate restrictions on capital repatriation, share buy-back, etc. May not be suitable for marketing to investors.</li> </ul>
Hong Kong	<ul style="list-style-type: none"> <li>• The open-ended fund company (“<b>OFC</b>”) regime may be used for a privately offered fund. Relevant tax exemption is also available subject to conditions. However, this regime is relatively new (19 cases so far according to the SFC website). The set-up of an OFC requires SFC approval.</li> <li>• The limited liability partnership fund (“<b>LPF</b>”) regime is catered for private equity funds. It is easy to register and no prior-regulatory approval is required. It is a new regime and the acceptance among investors is yet to be tested. Tax exemptions are available subject to conditions. A “re-domiciliation” regime to be introduced to allow foreign funds to migrate to HK.</li> </ul>
Mainland China	<ul style="list-style-type: none"> <li>• Qualified Foreign Limited Partnership/Limited Partnership Enterprise (“<b>QFLP</b>”) regime allows foreign LPs participation in onshore RMB fund vehicles (subject to foreign exchange/regulatory approvals/registrations). There are uncertainties on the calculation of taxes for LPs, withholding tax rates, etc., subject to local practices.</li> </ul>

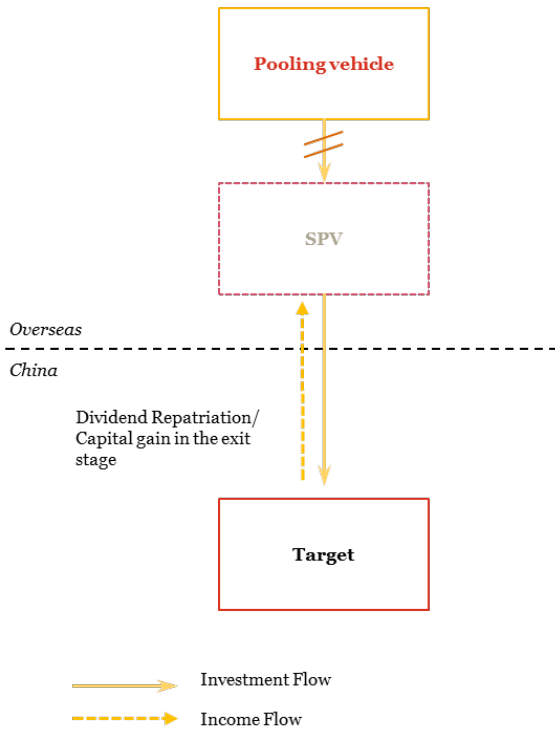
Key considerations	Cayman Islands	Singapore		Hong Kong	
	<u>Exempted Company</u>	<u>Authorised VCC</u>	<u>Restricted/ Exempt VCC</u>	<u>OFC</u>	<u>LPF</u>
Number of Directors required	1	3 directors are required. With at least 1 independent director for retail fund	1 executive director and at least 1 independent director	2, with at least 1 director independent of the custodian	1 general partner and at least 1 limited partner
Directors' residence requirement	No	1 director must be resident		No	No residence requirement for general partner or limited partner
Fund manager	No requirement on having a fund manager director No requirement on the location of the fund manager	At least 1 fund manager director Fund manager should be located locally		Requires a Type 9 (asset management) licensed Investment Manager under SFC	If no regulated activities under SFO is involved, there is no need to appoint an external licensed investment manager
Minimum capital requirement of the Fund	N/A	N/A		N/A	
Prepare Financial Statement at sub-fund level	Yes	Yes		Yes	Sub-fund not applicable
Public availability of Financial Statement	No	No		No	



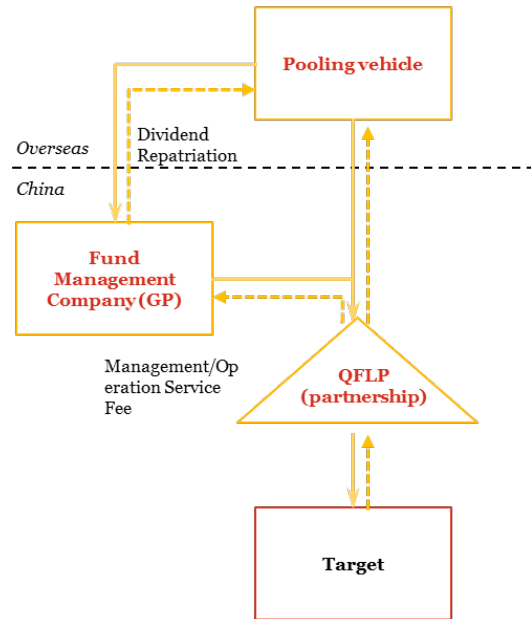
Key considerations	Cayman Islands	Singapore		Hong Kong	
	<u>Exempted Company</u>	<u>Authorised VCC</u>	<u>Restricted/ Exempt VCC</u>	<u>OFC</u>	<u>LPF</u>
Financial Statement GAAP	Any GAAP	Presentation as per the Code of Collective Investment Schemes	SFRS, IFRS, US GAAP	HKFRS or IFRS	No limitations on the use of certain accounting methods as long as there is audit
Submission of Financial Statement to authority	CIMA	ACRA		SFC	FS needs to be audited but no submission requirement
Public availability of shareholder lists	No	No		No	
Re-domiciliation	Yes	Yes		Yes	

## Typical investment structures – Mainland China

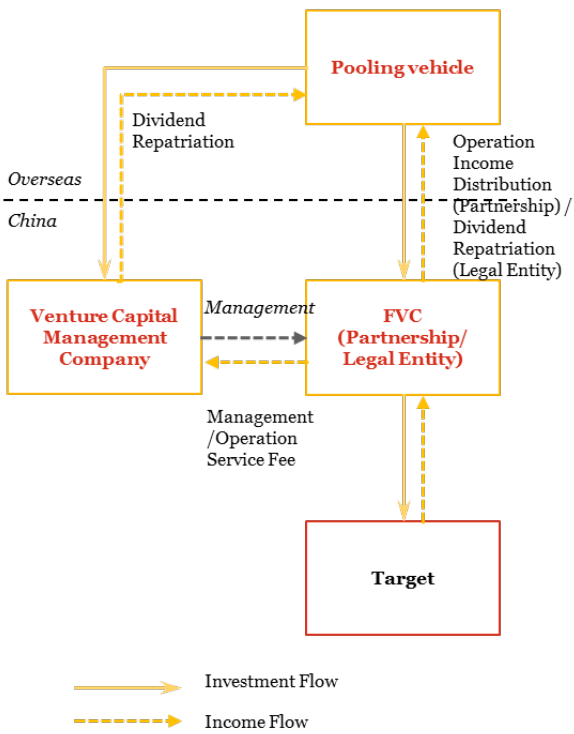
### Foreign Direct Investment



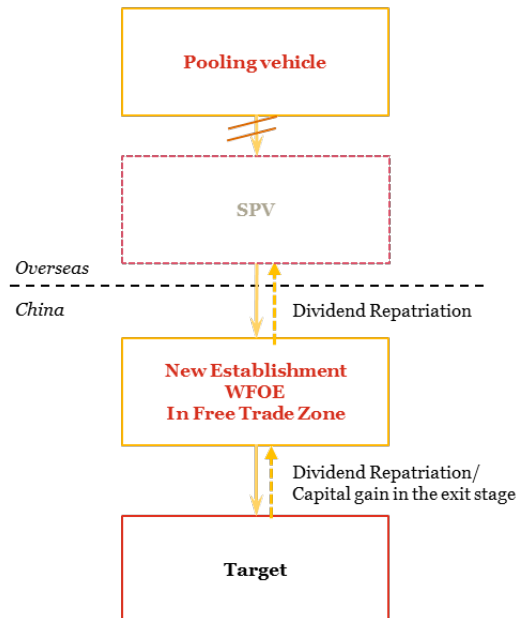
### Qualified Foreign Limited Partnership



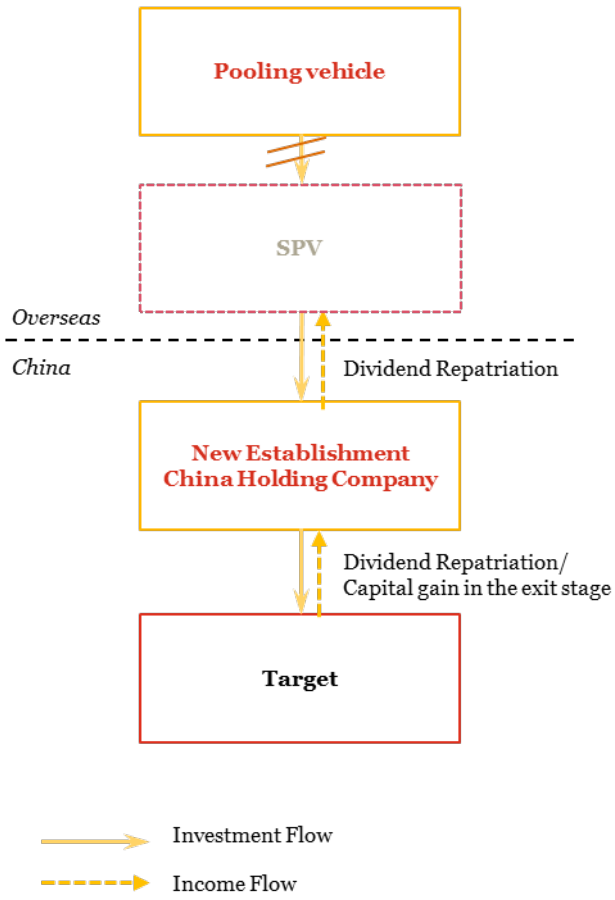
### Foreign Invested venture Capital



### WFOE in FTZ



## China Holding Company



# 04

## Key contacts



## Your primary contact for Investment Funds and Regulatory work:



**Gaven Cheong**  
Partner and Head of Investment Funds  
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Gaven is Head of Investment Funds at Tiang & Partners. Prior to joining Tiang & Partners, Gaven was an equity partner in the investment funds group of Simmons & Simmons (Hong Kong), and before that, a Counsel in another reputable international investment funds practice in Hong Kong.

With over 15 years of fund formation and Hong Kong regulatory experience, Gaven is able to assist clients in the establishment and structuring of a diverse range of collective investment schemes including hedge funds, real estate funds, private equity arrangements, hybrid funds and other private investment structures, and regulatory advice in relation to investment management activity generally. He is also a pioneer in the crypto fund formation and regulatory advice space, having helped obtain the first regulatory licences in Hong Kong for the management of a fund of crypto funds and shortly after that, a pure virtual assets fund. Prior to becoming a funds lawyer, Gaven was a contentious insolvency lawyer with two other international firms. He regularly advises on the entire lifecycle of investment funds, from inception, restructuring through to termination.

Gaven is listed as an “Up and Coming” lawyer in “Investment Funds” by *Chambers Asia-Pacific*, and a recommended individual in “Investment Funds” by *Legal 500 Asia Pacific* and “Private Funds – Formation” by *Who’s Who Legal*. In recent editions of Chambers, clients praised Gaven for being “practical and shrewd in terms of getting down to the key points in relation to any matter”, “a very bright individual” and for having “good response time and a business mind”.

Gaven received his Bachelor of Commerce (Accounting and Finance), LL.B (Hons) and LL.M (Distinction) from the University of Western Australia. He is qualified to practise in Western Australia, Hong Kong and England & Wales. He is fluent in English and Cantonese, and is conversant in Mandarin.

### Areas of expertise

- Investment funds (private hedge, PE and hybrid funds)
- Virtual assets - crypto fund formation and regulatory
- Financial services regulatory (primarily non-contentious)
- Fund and asset management-related disputes

### Representative experience

- Advising as lead counsel on the establishment of a number of large and reputable PE fund launches.
- Advising on a number of crypto fund launches.
- Advising fund managers and sponsors on the virtual assets regulatory regime in Hong Kong and assisting with applications to the SFC for various virtual assets licences.
- Providing general regulatory advice to numerous asset management, investment funds, private equity and other financial services companies.
- Advising on asset management-related disputes.

**Key Funds and Regulations team members:**



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  - Employment arrangements (including the hiring of Responsible Officers and Licensed Representatives)
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  - Trade finance
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- Preparing IP/regulatory disclosures/SPAs/other documents
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- IP disputes



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