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Morgan Lewis Hedge Fund University™
Hedge Fund Global Marketing Series

MARKETING OF FUNDS

**IN HONG KONG AND
MAINLAND CHINA**

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Agenda

- Marketing private funds to investors in Hong Kong and mainland China
- Recent Hong Kong Securities and Futures Commission's focus on marketing and licensing requirements applicable to private equity fund managers
- Opening of mainland China's financial services sector

MARKETING PRIVATE FUNDS TO INVESTORS IN HONG KONG

Helen Fok

Marketing Private Funds to Investors in Hong Kong

- Marketing Restriction (Section 103 of the Securities and Futures Ordinance (the SFO))
- Licensing Restriction (Sections 114 and 115 of the SFO)

Marketing Private Funds to Investors in Hong Kong

- Marketing Restriction (Section 103 of the SFO)
- If the funds are being marketed or offered to the Hong Kong public, their offering documents will need to be authorized by the Hong Kong Securities and Futures Commission (the SFC), unless an exemption is available
 - professional investor exemption (institutional professional investors, ultra-high-net-worth investors)

Marketing Private Funds to Investors in Hong Kong

- Licensing Restriction (Section 114 of the SFO)
 - distribution and marketing of funds in Hong Kong will fall within the regulated activity of dealing in securities, a Type 1 regulated activity in Hong Kong
 - exemption – “chaperon exemption” (e.g., using a placement agent or any Type 1 licensed intermediary)
- Active Marketing Restriction (Section 115 of the SFO)
 - no person shall actively market any offshore financial services to the public, that if provided in Hong Kong, will be a regulated activity in Hong Kong
 - no exemption; however, there is a tolerated market practice when marketing to institutional professional investors
 - what is “active marketing”
 - definition of “public”
 - extra-territorial effect

Licensing Requirements for Hedge Funds and Private Equity Firms in Hong Kong

- The most relevant regulated activities are:
 1. Dealing in securities (Type 1)
 2. Advising on securities (Type 4)
 3. Asset management (Type 9)
- 1. Dealing in securities (Type 1)
 - The broad scope of what is meant by “dealing in securities” means that many activities relating to “securities” are considered by the SFC to constitute dealing, including “securing a deal”, and arguably “sourcing” a deal
 - “*Securing a deal*”: The SFC has begun to refine their interpretation of “dealing in securities” and “advising on securities” regulated activities.
 - whether the negotiations being undertaken, whether on an acquisition or a disposal, are an integral part of “securing the deal”

Licensing Requirements for Hedge Funds and Private Equity Firms in Hong Kong

- 2. Advising on securities (Type 4)
 - Licensing exemption – “Intra-group” exception
 - The exception is available if advice on securities is provided by the Hong Kong company to:
 - any of its wholly-owned subsidiaries
 - a holding company which wholly owns the Hong Kong company; or
 - wholly-owned subsidiaries of its holding company.
 - The recipient of the advice, recommendation, or research should assess the advice, recommendation, or research and has the discretion to reject it before issuing the material to its own clients in its own name. In other words, the recipients must assess the advice, and not merely rubber-stamp it.
- 3. Asset management (Type 9)
 - Type 9 license is required for managing a portfolio of securities or futures contracts on a discretionary basis
 - Incidental exemption (i.e., you may market funds under your management or sub-management without a Type 1 license)

MARKETING PRIVATE FUNDS TO INVESTORS IN MAINLAND CHINA

Cindy Pan

Marketing Offshore Private Funds to Investors in Mainland China

- No authorization or registration regime available
- General marketing activities
 - Rules and general practice
 - Issues to be aware of
- Marketing of specific products
 - Rules and general practice
 - Target investors
 - QDIIs, QDLPs, and QDIEs
 - China sovereign funds
 - Non-financial Chinese companies
 - High-net-worth individuals

Target Investors – Investment Scope of QDIIs

Type of QDII Institution	Scope of Outbound Investment
Securities Companies Fund Managers	<ul style="list-style-type: none"> money market instruments fixed-income products securities issued by CSRC-recognized international financial organizations equity products (including shares, global/US depository receipts and REITs) listed on a stock exchange in a country or region that has signed a MoU on the bilateral regulatory cooperation with the CSRC <ul style="list-style-type: none"> structured products public funds registered with the securities regulatory authority in a country or region that has signed a MoU on the bilateral regulatory cooperation with the CSRC financial derivatives listed and traded on CSRC-recognized offshore stock exchanges other products approved by the CSRC
Commercial Banks	<ul style="list-style-type: none"> fixed-income products (rated as BBB or above) shares listed on a stock exchange in a country or region that has signed a MoU on the bilateral regulatory cooperation with the CBIRC structured products (issuer rated as A or above) <ul style="list-style-type: none"> public funds approved or recognized by or registered with a securities regulator in a country or region that has signed a MoU on the bilateral regulatory cooperation with the CBIRC other products approved by the CBIRC
Trust company	<ul style="list-style-type: none"> money market instruments (rated as investment grade or above) equity products (including shares, global/US depository receipts and REITs) listed on a stock exchange in a country or region that has signed a MoU on the bilateral regulatory cooperation with the CBIRC <ul style="list-style-type: none"> public funds approved by or registered with by a securities regulator in a country or region that has signed a MoU on the bilateral regulatory cooperation with the CBIRC structured products (rated as investment grade or above) other products approved by the CBIRC
Insurance Companies	<ul style="list-style-type: none"> money market instruments (rated as A or above) traded in a CBIRC-recognized country or region fixed-income products (issuer and product rated as BBB or above) traded in a CBIRC-recognized country or region equity products (including shares, global/US depository receipts, and REITs) listed on a CBIRC-recognized offshore stock exchange shares of unlisted companies (limited to industries of finance, pension, health care, energy, resource, automobile service, and modern agriculture) real estate (located in a CBIRC-recognized market) <ul style="list-style-type: none"> securities investment funds recognized by or registered with the securities regulator in a CBIRC-recognized country or region private equity funds with the investment target located in a CBIRC-recognized country or region (but if the investment target is at the growing or maturity stage or has a relatively high acquisition value, such investment target can be in a non-CBIRC recognized country or region), which have a total capital commitment of no less than US\$300 million and its paid-in capital is in place in proportion to the amount of the capital commitment REITs listed on a stock exchange in a CBIRC-recognized country or region other products approved by the CBIRC

Marketing Onshore Private Funds to Investors in Mainland China

- Registration status of QDLPs and foreign-invested private securities investment fund managers
- Rules of private fund marketing in mainland China
 - General marketing activities
 - Marketing of specific fund products
 - Qualified investors
 - Number of qualified investors for each fund product
 - No public marketing
 - Requirements on marketing materials
 - Fundraising personnel qualification

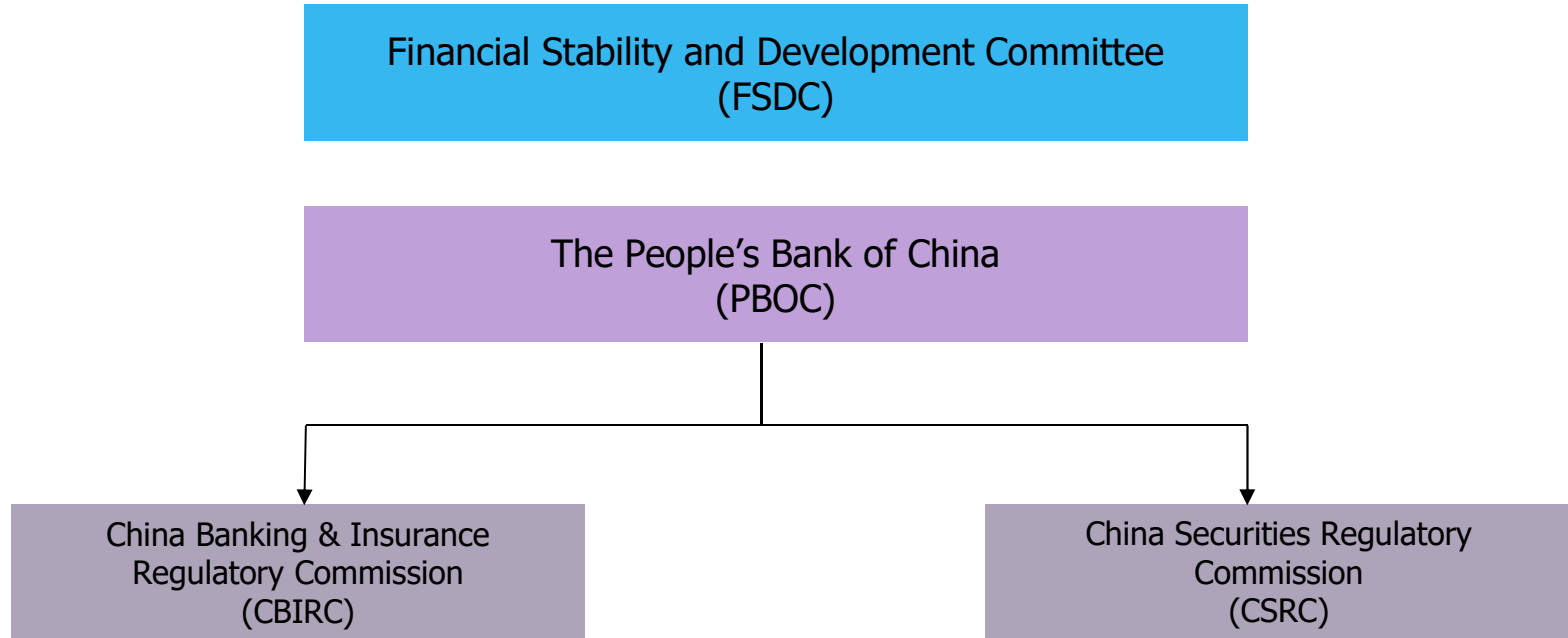
OPENING OF MAINLAND CHINA'S FINANCIAL SERVICES SECTOR

Alice Huang

Opening of Mainland China's Financial Services Sector

- Coordinated approach with regulatory oversight of financial services industry
 - Establishment of the State Council's Financial Stability Development Committee ("FSDC") in late 2017.
 - In April 2018, China Banking and Insurance Regulatory Commission ("CBIRC") is established by consolidating the banking and insurance regulatory committees. The consolidation aims to eliminate inefficiencies and regulatory overlap across agencies, while also clarifying supervisor responsibilities and closing loopholes for regulatory arbitrage.

Opening of Mainland China's Financial Services Sector



Opening of Mainland China's Financial Services Sector

- Recent developments to further open up mainland China market to foreign financial institutions (FIs)
 - Acceleration of removal of foreign ownership restrictions:
 - Securities companies: from 2021 to December 1, 2020
 - Fund management companies: from 2021 to April 1, 2020
 - Futures brokers: from 2021 to January 1, 2020
 - Life insurance companies: from 2021 to 2020
 - Removal of minimum total asset thresholds market-entry requirement for foreign FIs (banks, trust companies, and insurance brokerage companies)

Opening of Mainland China's Financial Services Sector

- Business considerations to go onshore:
 - Organic growth, collaboration, JV, M&A
 - Operational complexities
 - Challenges in navigating regulatory environment that from time to time is subject to overarching macro government policies
 - Scalability and marketing of products tailored for the domestic market
 - Innovations, competitions from non-traditional FIs

Opening of Mainland China's Financial Services Sector

	Pros	Cons
WFOE	<ul style="list-style-type: none">• Easier to adopt the global strategy of the parent company.• Operational efficiency and use of parent company resources.• Better IP protection.	<ul style="list-style-type: none">• May take longer to establish and obtain approval.• Potential challenges in navigating the local business and regulatory environment.
JV	<ul style="list-style-type: none">• Initial set up may be faster.• Local partner can provide access to existing local distribution channels.	<ul style="list-style-type: none">• Challenges to find a suitable local JV partner.• Operational synergies; IP protection considerations, etc.• Challenges to conform to global compliance requirements.

IMPLICATIONS FOR US MANAGERS MARKETING PRIVATE FUNDS TO INVESTORS IN HONG KONG & MAINLAND CHINA

Brendan Kalb

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- Intellectual Property Protection
 - Chinese law offers comprehensive protection of patents, trademarks, trade secrets and copyrights, however, there is widespread violation and ineffective enforcement of law. So, the key for any manager seeking to sell products in China is to create and implement a practical and effective action plan.
- Tax Considerations
 - A U.S. company may be subject to China's enterprise income tax for certain China-sourced income such as interest, royalties, capital gains, etc. In addition, revenue generated from a licensing arrangement is subject to a business tax in China.
- Dispute Resolution
 - While having the Chinese party submit to exclusive jurisdiction in a U.S. court would be the ideal solution, the problem with this approach is that no treaty exists between the two countries to enforce foreign judgments.
- Labor Law Compliance
 - A U.S. company with employees in China, usually through its Chinese subsidiary, should acquaint itself with the mandatory requirements of this new law, which are very different than what is customary for a U.S. employer.
- Transfer Pricing
 - In order to compensate your team and allocate appropriate cash flows into your new subsidiary, you will want to know exactly how much cash you can direct to your new Asian operation.

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- Prepare Legal Documents to Sub-Advise Existing and New Entities
 - With the company in existence, your advisory agreement and existing counterparty documentation may need to be revised. At the very least, all of the advisory contracts will need to be amended to (1) add the new group entity and (2) implement the recommendations of the transfer pricing study.
 - If it is intended that the Asian office will include a trading desk, then trading counterparties will seek to conduct diligence on the new entity and to see the executed advisory agreements. They may then ask you to fill out supplemental paperwork authorizing the new entity to execute trades on behalf of your fund(s). Note that at this point, your counterparties may require a new KYC process to onboard the new entity.

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- General Regulatory Framework – SFC in Hong Kong
 - The SFC’s Licensing Information Booklet is a comprehensive guide to the requirements. This structure is helpful for U.S. managers in that any Hong Kong-based subsidiary can adopt pre-existing U.S. policies and procedures and by doing so meet or exceed the requirements found in the Code of Conduct with only minor modifications in most cases.
 - Hong Kong requires managers undertaking regulated activities, including investment management, to register as Hong Kong registered advisers and their advisory staff must meet appropriate criteria in order to run a management company in Hong Kong. This will in most cases result in some of the senior staff needing to sit for the Hong Kong licensing examinations in order to be eligible to manage the subsidiary office in Hong Kong.
 - The SFC has published guidance on applicable exemptions/relaxations for managers who wish to set up a research/advisory only office or who are otherwise linked to a foreign parent through a group structure.
 - An alternative to forming a Hong Kong subsidiary company to operate in Hong Kong would be to form a Hong Kong “branch office” of a foreign company.

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- Regulatory Capital Requirement
 - Hong Kong requires a minimum amount of “liquid capital” to be maintained by the regulated entity. This minimum is set at HK \$100,000 (USD \$12,820) or five percent (5%) of “adjusted liabilities” and must be maintained at all times.
 - Managers have a biannual reporting requirement in July and February along with a prompt updating requirement under certain conditions. Given the requirement that regulatory capital be monitored at all times (and given that this is an area of particular focus by the SFC), it would be advisable for a manager’s finance team to review the rules early to set up systems to enable daily monitoring of regulatory capital.

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- SFC Registration
 - Any launch, large or small, will be subject to scrutiny during the registration process. Due care should be spent in preparing the application and toiling through the details. Moreover, like the Monetary Authority of Singapore, the SFC is a “hands on” regulator, meaning that it likes to have contact with the company. It is advisable to schedule a time prior to filing when relevant senior team members can meet the staff. Accordingly, any manager should prepare for a colloquy prior to being declared effective.
 - Part of the regulatory application is a formal undertaking by the company and the senior staff associated with the company that all participants are “fit and proper” to conduct regulated activities. The questions are similar to those found in the SEC’s Form ADV Part I with regard to prior acts, but act as an affidavit or formal undertaking as all representatives are required to sign the forms.
 - Finally, like the Form ADV, prompt updating of SFC forms is required for any changes to the particulars of the business, management, and staff.

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- People on the Ground
 - While only a single person is required to be resident in Hong Kong in order to maintain an office, there still remain many middle and back office support functions, but these may be outsourced to the home office, so long as the regulatory requirements are met.
 - Of note, the person/people on the ground would typically be considered to be so-called “responsible officers” (and subject to separate “Responsible Officer” license approval by the SFC) for all filings and representations made by the subsidiary in Hong Kong.
 - Accordingly, those Responsible Officers should be briefed to understand what their full responsibilities are in this dual-hatted role. Given the scope of work involved, it may be preferable to have one front-office and one operations/legal staff resident in Hong Kong to ensure that all requirements are being met timely.

Implications for US Managers Marketing Private Funds to Investors in Hong Kong & Mainland China

- Marketing, Disclosure & Enforcement
 - The SFC takes seriously suitability requirements, so managers should be prepared to demonstrate that they are following a process in screening potential investors for products being marketed to investors based in Asia. Following a standard Regulation D seasoning period by establishing a relationship prior to allowing investment would suffice to meet any suitability requirements sought in Hong Kong.
 - The SFO grants to the SFC criminal jurisdiction over certain violations of the securities laws in Hong Kong. This differs from the United States, where the SEC has civil authority and must conduct joint investigations with the DOJ in situations where criminal liability is sought. Accordingly, the potential scope of penalties for misconduct is higher in Hong Kong than in the United States.
 - Managers based in other jurisdictions should also be aware that regulatory inquiry in Hong Kong may lead to the same conduct being investigated by the home jurisdiction.

BIOGRAPHIES

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With a focus on financial regulatory matters, Helen Fok advises banks, financial institutions, asset managers, hedge fund managers, alternative trading platforms, and sovereign wealth funds on all aspects of financial regulation. The breadth of her practice includes advising licensing applications and ongoing regulatory matters under the Securities and Futures Ordinance, the Banking Ordinance, and the Payment Systems and Stored Value Facilities Ordinance, and on conduct of business rules, conflicts of interests, product governance, investor classification, suitability, and corporate governance issues, including the implementation of the Hong Kong Manager-in-Charge regime.

Helen has also been involved in a number of client agreements for securities and futures brokers, private wealth managers (with onshore/offshore booking models), fund managers, custodians, and clearing members. Additionally, she has advised on the regulatory aspects of a number of mergers and acquisitions transactions. Helen is fluent in English and Mandarin.

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Alice Huang concentrates her practice on private investment funds, advising registered and unregistered investment advisers based in the United States and in the Asia Pacific region on the formation, structure, and ongoing management of investments in global markets. Alice also represents institutional investors in negotiating operating and side letter agreements for investments in global private funds.

Prior to joining Morgan Lewis, Alice practiced at a top regional law firm, resident in Hong Kong, and before that she worked at other top US law firms focusing on private investment funds and cross-border transactions. From 2012–2014, she served as general counsel for an Asia Pacific private equity fund based in Hong Kong, where she managed the companywide legal, compliance, and tax functions with respect to the company's operations and investments in China, Hong Kong, South Korea, Taiwan, Tokyo, and the United States.

Prior to practicing law, Alice was a senior tax manager with Deloitte Touche Tohmatsu in Los Angeles, where she advised clients on inbound and outbound tax transactions. She also spent a year in Shanghai assisting multinational clients in China with cross-border and China tax and regulatory issues, including mergers and acquisitions, structuring, feasibility studies, transfer pricing and foreign exchange.

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Cindy Pan focuses on asset management and corporate matters.

She advises international financial institutions, asset managers and hedge fund managers on their cross-border investments (e.g. QFII/RQFII, QDLP/QDIE, QDII/RQDII, CIBM, Stock Connect and Bond Connect,) and other general PRC regulatory issues. She represents asset managers on application with AMAC for the private fund manager license and RMB fund registration in China and provides advices in connection therewith. She also provides advice regarding the formation, structure, and ongoing management of private investment funds. Cindy also advises several China exchanges and Chinese future companies on financial regulations.

In addition, Cindy counsels international and Chinese clients on a wide variety of corporate, real estate, commercial, and financing matters. These include foreign direct investment, joint ventures, cross-border mergers and acquisitions and real estate acquisition.

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Brendan R. Kalb utilizes his in-house asset management and corporate legal experience to counsel clients on issues relating to the establishment and ongoing operation of global hedge funds, private equity funds, commodity pools, UCITS funds, hybrid customized vehicles, and separately managed accounts, along with providing regulatory, compliance, and trading advice to managers investing in various asset classes in the United States and abroad. He also has deep experience advising on the structuring and operation of various registered fund products, including liquid alternative funds.

Prior to joining Morgan Lewis, Brendan was the managing director and general counsel at AQR Capital Management, LLC, a systematic global asset management firm based in Greenwich, CT, where he was responsible for managing the full spectrum of the firm's legal affairs, including involvement in all aspects of US and overseas regulatory exams, product structuring, derivatives and operational risk management, quantitative investment practices, drafting of investment guidelines and restrictions, creation and update of compliance policies and procedures, as well as implementation and interpretation of international rules and regulations regarding trading and marketing.

Prior to joining AQR in 2004, he worked as an investment management associate in the New York office of an international law firm, where he regularly represented registered investment companies, investment advisers, commodity pool operators, commodity trading advisors, and broker-dealers.

Jedd H. Wider



Jedd H. Wider focuses on global private investment funds and managed accounts, particularly global hedge, private equity, secondary, and venture capital funds. As co-leader of the global hedge funds practice, he represents leading financial institutions, fund managers, and institutional investors in their roles as fund sponsors, placement agents, and investment entities. He assists clients through all stages of product development and capital raising as well as customized arrangements, seed and lead investor arrangements, and joint ventures. He specializes in all aspects of secondary transactions, and complex financial structurings.

Jedd concentrates on all aspects of bespoke fund products and arrangements including funds of one and managed accounts and regularly advises clients on all aspects of regulatory compliance.

Members of the international media often seek out Jedd for his views on the hedge fund and private equity fund industries and capital markets. His analysis can be found in US and international publications, including *The Wall Street Journal*, *The Economist*, and *Financial Times*, as well as on television networks such as Bloomberg and CNN.

Jedd lectures and serves as a panelist on private investment fund topics for trade programs and organizations around the world. He has delivered speeches and presentations to numerous private fund conferences such as the Hedge Fund Institutional Forum, Dow Jones Private Equity Analyst Limited Partners Summit, Endowments & Foundations Roundtable, Association of Life Insurance Counsel, National Association of Public Pension Fund Attorneys (NAPPA), West Legalworks, InfoVest21 Hedge Fund Conference, the Annual Euromoney Summit of European Hedge Funds in London, Capital Roundtable Fund Conferences, the Annual International Conference on Private Investment Funds in London, the Wharton Private Equity and Venture Capital Conference, the On Point Investors and Hedge Fund Risk Summit, and the Lazard Capital Markets Hedge Fund Conference.

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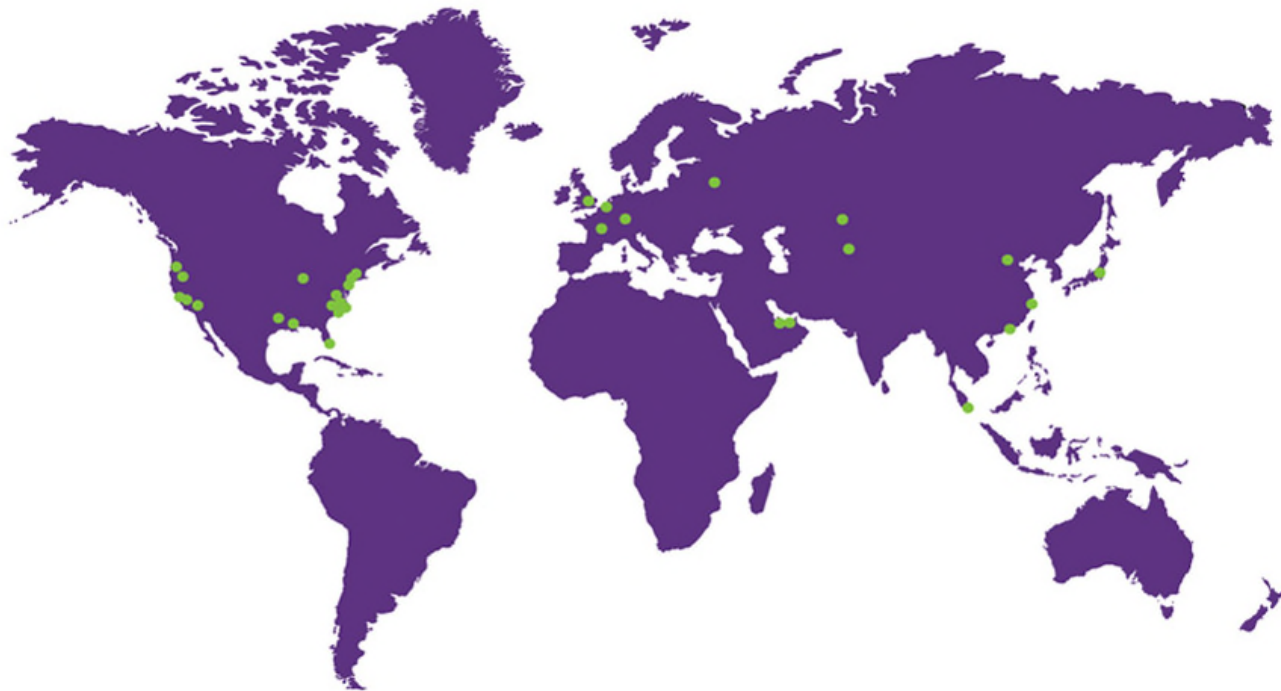
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