



Hong Kong

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SFC ISSUES LICENSING GUIDANCE FOR HONG KONG PRIVATE EQUITY FIRMS AND FAMILY OFFICES

On 7 January 2020, the Securities and Futures Commission (SFC) announced¹ the publication of two SFC circulars providing guidance on the SFC licensing obligations of private equity firms (**Hong Kong private equity firms**) and family offices (**Hong Kong family offices**) which conduct business in Hong Kong, in response to enquiries from industry participants and their professional advisers.

The SFC's Circular to private equity firms seeking to be licensed² provides information on the SFC's licensing requirements for Hong Kong private equity firms' general partners, investment committee members and fund marketing activities. It also clarifies the industry experience requirement for responsible officers of private equity firms and how the SFC assesses private equity firms' discretionary investment authority.

The SFC's Circular on the licensing obligations of family offices³ provides guidance on the application of the SFC's licensing regime to family offices proposing to carry out asset management or other services in Hong Kong. It explains the licensing implications for single and multi-family offices as well as the licensing exemptions and carve outs which may be available.

- 1 SFC. "SFC provides licensing guidance for private equity firms and family offices". 7 January 2020. <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR2>
- 2 SFC. "Circular to private equity firms seeking to be licensed". 7 January 2020. <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=20EC2>
- 3 SFC. "Circular on the licensing obligations of family offices". 7 January 2020. <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=20EC1>

I SFC Circular to Private Equity Firms Seeking to be Licensed

The SFC circular to Hong Kong private equity firms gives general guidance on applying to the SFC for a licence to conduct regulated activities under Part V of the Securities and Futures Ordinance (Cap. 571) (SFO).

A. Licensing requirements for Hong Kong private equity firms' general partners

Private equity funds are often established as limited partnerships whose general partner is ultimately responsible for the private equity fund's management and control. Given the general partner's role in managing the private equity fund, it will generally need to be licensed for SFC Type 9 regulated activity (asset management) if its activities in Hong Kong constitute asset management business (as defined in the SFO). Individuals performing asset management activities in Hong Kong on behalf of the general partner must also be licensed as representatives accredited to the licensed general partner, and two individuals need to be approved as the general partner's responsible officers for its asset management business.

A general partner will not however need to be licensed if it delegates all its asset management functions to another entity which holds a Type 9 licence or registration. In these circumstances, the unlicensed general partner must ensure that it does not represent to any prospective investor that it manages a private equity fund in Hong Kong because doing

so would breach section 114 of the SFO, which prohibits any unlicensed person from holding himself out as carrying on a business in a regulated activity.

B. Hong Kong private equity firms' discretionary investment authority

In order to differentiate SFC Type 9 regulated activity from the regulated activities of advising on securities or futures contracts (Type 4 or Type 5 regulated activity), the SFC requires SFC-licensed asset managers to have full discretionary investment authority for the funds they manage (Paragraph 1.4.24 of the SFC Licensing Handbook⁴). In determining whether a Hong Kong private equity firm has such authority, the SFC will look at the facts of each case, including: (i) the proposed investment decision-making process; (ii) the roles of the proposed licensed individuals (including the responsible officers) and their involvement in the process; and (iii) whether the delegation of investment authority to the Hong Kong private equity firm is properly documented.

For example, the SFC may consider a Hong Kong private equity firm to have discretionary investment authority if the firm will have a responsible officer with sufficient authority and seniority to make investment decisions for the entire life cycle of each fund.

C. Hong Kong private equity funds' investment committee members

It is quite common for Hong Kong private equity firms licensed for SFC Type 9 regulated activity to establish investment committees in Hong Kong. Members of an investment committee who play a dominant role in making investment decisions for the funds, whether on an individual or joint basis, are generally required to be licensed as representatives, and where appropriate, should also be approved as responsible officers.

Those investment committee members who have no voting right or veto power for investment decisions and whose primary role is to provide input from a legal, compliance or internal control perspective, are generally not required to be licensed by the SFC.

D. Hong Kong private equity funds' investments in private company securities

"Asset management" as defined in the SFO includes, amongst other things, the provision of a service of managing a portfolio of securities or futures contracts for another person. The SFO's definition of "securities" however excludes the shares and debentures of a company that is a private company under section 11 of the Companies Ordinance (Cap. 622), that is, a private company incorporated in Hong Kong.⁵

Many Hong Kong private equity funds set up special purpose vehicles (**SPVs**) in Hong Kong or overseas to hold investments. In determining whether an investment portfolio of a private equity fund comprises securities or futures contracts for the purpose of SFC Type 9 regulated activity, the SFC will consider the composition of the entire investment portfolio. If a private equity fund's underlying investments held through an SPV are "securities" under the SFO (even if the SPV is carved out), or the SPV shares themselves are "securities", the SFC will regard the management of the portfolio as "asset management" and the private equity firm must be licensed for SFC Type 9 regulated activity.

E. Hong Kong private equity funds' offering co-investment opportunities

If a Hong Kong private equity firm offers investment opportunities to other persons allowing them to enter into securities transactions alongside the private equity fund, the Hong Kong private equity firm is generally required to be licensed for SFC Type 1 regulated activity (dealing in securities). This is because the act of offering co-investment opportunities would likely be regarded as inducing other persons to enter into securities transactions, which constitutes dealing in securities as defined in Part 2 of Schedule 5 to the SFO.

However, a private equity firm that holds a Type 9 licence will not need to be licensed for Type 1 regulated activity if it offers the co-investment opportunities solely for the purposes of carrying on Type 9 (by virtue of the carve-out from the definition of "dealing in securities" in sub-paragraph (xiv) of the definition in Part 2 of Schedule 5 to the SFO). Thus, if offering co-investment opportunities is an integral part of the private equity fund's fundraising to secure capital to invest in

⁴ SFC Licensing Handbook available at <https://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/licensing-handbook/licensing-handbook.pdf>.

⁵ See sub-paragraph (i) under the exclusions from the definition of "securities" in Part 1 of Schedule 1 to the SFO and paragraph 1.4.18 of the SFC Licensing Handbook.

its underlying projects, the private equity firm would not be required to be licensed for SFC Type 1 regulated activity.

F. Fund marketing activities by Hong Kong private equity firms

Fund marketing activities generally constitute “dealing in securities” - SFC Type 1 regulated activity. Accordingly, a Hong Kong private equity firm carrying on a business in such activities would generally be required to be licensed for SFC Type 1 regulated activity unless an exemption under the SFO applies. For example, a private equity firm which is already licensed for SFC Type 9 regulated activity, will be able to market the funds it manages without being additionally licensed for SFC Type 1 regulated activity, as long as the related fund marketing activities are conducted by the Hong Kong private equity firm solely for the purposes of carrying on its asset management activities, that is, SFC Type 9 regulated activity.

G. Industry experience requirements for responsible officers of Hong Kong private equity firms

The SFC adopts a pragmatic approach when assessing whether a Hong Kong private equity firm’s applicant for approval as a responsible officer has the relevant industry experience to satisfy the competence requirements under the SFC’s Guidelines on Competence, and will recognise a broad range of experience so long as the applicant can demonstrate its relevance to his or her proposed duties. Examples of the types of industry experience the SFC will consider include:

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

The SFC also accepts private equity firm experience gained in a non-regulated situation. It will consider experience in an overseas jurisdiction where the related private equity activities are not regulated, as well as relevant experience in a private equity 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 private equity firm’s holding company.⁶

II SFC Circular on the Licensing Obligations of Family Offices

The SFC Circular on the licensing obligations of family offices⁷ provides general guidance for family offices intending to carry out asset management or other services in Hong Kong.

A. General SFC licensing requirements for Hong Kong family offices

As the Hong Kong licensing regime under the SFO is activity-based, there is no specific licensing regime for family offices. If the services provided by a family office are regulated activities under the SFO, it must apply for an SFC licence to carry on those activities, unless they are exempt or carved-out from the licensing regime. A family office is not required to be licensed with the SFC if its services do not constitute any regulated activity or fall within an exemption or carve-out. Family offices must however take care to ensure that they do not hold themselves out as carrying on a business in a regulated activity, which is an offence under the SFO.

If a company or family office is set up as a business to manage assets which include securities or futures contracts, it will need to hold a licence for SFC Type 9 regulated activity (asset management which is defined as real estate management and securities or futures contract management), unless an exemption applies. 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 an SFC licence is required.

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

⁶ Paragraph 1.3.14 of the Licensing Handbook.

⁷ <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=20EC1>

B. Hong Kong Single family offices

Whether a family office needs to be licensed for SFC Type 9 will depend on: (i) the form of legal entity; and (ii) whether the family office is granted full discretionary investment authority. For example, where a family appoints a trustee to hold the 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 an SFC Type 9 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 an SFC Type 9 licence as it will qualify for the intra-group exemption⁸ as full discretionary investment manager of the securities or futures contracts portfolio. This is because the family office is not required to be licensed for the SFC Type 9 regulated activity if it provides asset management services only to its wholly-owned subsidiaries, its holding company which holds all its issued shares, or to that holding company's other wholly-owned subsidiaries (**Intra-group Exemption**).

C. Hong Kong 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 (i) its wholly-owned subsidiaries; (ii) its holding company which holds all its issued shares or (iii) that holding company's other wholly-owned subsidiaries, it will not be able to rely on the Intra-group Exemption.

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 hence it would likely need to be licensed for SFC Type 9 regulated activity.

If the multi-family office has not been delegated full discretionary investment authority and only provides securities investment advice and executes securities transactions, it may need to be licensed by the SFC for other types of regulated activities, i.e., SFC Type 1 regulated activity (dealing in securities) and

SFC Type 4 regulated activity (advising on securities). Where the assets include futures contracts, it may also need to be licensed for SFC Type 2 regulated activity (dealing in futures contracts) and SFC Type 5 regulated activity (advising on futures contracts).

⁸ Under paragraph (a) of the definition of "securities or futures contracts management" in Schedule 5 to the SFO, there is an exclusion for a corporation which provides securities or futures contract management services solely to members of its wholly owned group.

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