

Hong Kong



Limited Partnership Fund Ordinance

Comes into force 31 August for private funds in Hong Kong

The Limited Partnership Fund Ordinance (Cap 637) (LPFO) comes into operation on 31 August 2020, providing a rather ground breaking new standalone entity framework for the formation of what has been termed limited partnership funds (LPFs) in Hong Kong.

The Companies Registry (the **Registry**) is tasked with the administration of LPFs and last week issued a circular setting out the various forms and processes needed. We view the appointment of the Registrar of Companies (the **Registrar**) as the gatekeeper to be a real boost for the use and viability of LPFs given they are principally a filing and registration regulator at this time (as opposed to, for example the Securities and Futures Commission (SFC) which, as we all know, can be somewhat more work).

Background

The go-to industry standard structure for private equity has been Cayman Islands exempted limited partnerships (ELPs). Cayman ELPs offer sponsors and investors many advantages:

- Ease of use
- Industry acceptance – good reputation
- Provider support is widespread and knowledgeable
- General legal framework is accommodating:
 - simplicity in set up
 - statutory certainty for limited partners and general partners
 - flexibility in terms of capital contributions and distribution of profits
 - simple dissolution mechanism
 - confidentiality
 - tax neutrality
- Light touch regulation

It would be fair to say Hong Kong's laws, tax environment and regulatory framework have not made it easy for sponsors and investors to use Hong Kong as a domicile for funds over the years. But the LPFO is a fresh attempt to lure business and addresses many of the deficiencies of the LPFO's 100 year old predecessor while adopting

many of the benefits of ELPs. The timing is also good as the shimmering multitude of benefits traditionally associated to ELPs is being tarnished by increased cost, tax reporting encroachment, growing administrative burden, and more vigorous regulatory oversight and reporting.

Constitution and Registration Requirements for LPFs

To be registered as an LPF, it must:

- have a general partner
- have at least one limited partner
- be constituted by a limited partnership agreement
- designate a Hong Kong registered office
- appoint a Hong Kong auditor
- have the following functionaries:
 - an *investment manager* to carry out the day-to-day investment management functions (the general partner can assume this role)
 - a *responsible person* to carry out anti-money laundering and counterterrorist financing functions
 - an *authorised representative* if the general partner has no separate legal personality, which shall be responsible for the management and control of the LPF and jointly and severally liable with the general partner for the debts and obligations of the LPF
- ensure that not all the limited partners in the LPF are corporations in the same group of companies.

Key Features of an LPF

The characteristics of an LPF include the following:

- no separate legal personality (this is generated by the general partner)
- the LPFO imposes no restrictions on investment scope and strategy
- the general partner (and together with the authorised representative, if any) has:
 - unlimited liability in respect of all debts and obligations of the LPF
 - ultimate responsibility for the management and control of the LPF
- each limited partner's liability is limited to their contractual obligation to contribute, provided that the relevant limited partner is not participating in management of the LPF (the LPFO helpfully sets out the permitted safe harbour activities for a limited partner, which notably includes serving on an advisory committee of the LPF)
- custody arrangements must be made (no custodian required). If self-custody is adopted, the general partner must have policies and procedures in place to ensure that persons fulfilling the custodial function are independent from those carrying out the management function
- no requirement to have any offering documents
- the partners shall have freedom of contract on the operational matters of the LPF, including the scope of fiduciary duties of the general partner, and distribution and dissolution procedures
- the LPFO expressly provides for freedom of contract in respect of the LPFs operations
- the general partner or investment manager will have to be licensed by the SFC to carry out regulated activities in Hong Kong.

Enforcement by the Registrar

The Registrar may revoke the registration of an LPF under at least one of the following circumstances:

- it does not or no longer meets the eligibility requirements under the LPFO
- it does not have an investment manager, responsible person and/or authorised representative (if applicable)
- failure to commence operations or all the partners in the LPF are corporations in the same group of companies.

IRD Treatment of the LPF

An LPF, which will be treated as a separate entity for Hong Kong tax purposes, and will be able to take advantage of the unified fund regime under the Inland Revenue Ordinance (Cap 112) and be exempt from Hong Kong profits tax like any other offshore fund if it meets the relevant exemption conditions:

- the Hong Kong managers and advisers of an LPF will be subject to Hong Kong profits tax in the same way as they would in respect of an offshore fund. Details of proposed tax concessions for carried interests for private equity funds operating in Hong Kong have not yet been announced
- limited partner interests transferred in the LPF are not be subject to stamp duty in Hong Kong.

Ongoing Compliance

The general partner of an LPF must:

- file an annual return with the Registry each year within 42 days after each anniversary of the LPF's registration date
- notify the Registry of any changes in investment scope, registered office/address, general partner, investment manager or responsible person
- keep proper records of documents or information pertaining to the operations and transactions of the LPF (such as financial statements, transaction documents and a register of partners) at the registered office.

Anti-Money Laundering and Counter-Terrorist Financing

The general partner must appoint a *responsible person* to carry out anti-money laundering/counter-financing of terrorism functions for the LPF as stipulated under the Anti-Money Laundering and Counter-terrorist Financing Ordinance (Cap. 615). These include performing customer due diligence in respect of all investors in the LPF and continuous monitoring of business relationships and transactions. The *responsible person* must be an authorised institution, licensed corporation, accounting professional or a legal professional.

Winding-Up and Dissolution

Since private equity funds will typically be wound up and dissolved at the end of the investment term, the winding-up and dissolution mechanisms in the LPFO are a welcome feature. Helpfully, and if needed, an LPF can also be wound up as an unregistered company.

Our Opinion

In general the introduction of the LPF regime is very encouraging and the LPFO contains many attractive features. In respect of a few items, questions remain. Key amongst these is confidentiality, tax treatment for carried interest, and for un-licensed investment managers the need to monitor carefully all activities in the event that they may constitute SFC *regulated activities*. The use and function of the investment committee structure is also uncertain for those private equity funds seeking to have independent decision making entrenched in the fund structure.

For the right sponsor or manager, and of course the right investment scope and strategy, the LPF offers a viable alternative to Cayman Island ELPs.

Marbury Fund Services

No matter how much fund management experience you have, when you're running your own investment management venture you want to focus on portfolio management, performance and investors. Marbury's experienced professionals can help with LPF set-up and fund administration. We work closely with Hong Kong law firms on the Hong Kong law aspects of the LPFO.

We collaborate with Investment Managers to grow their businesses and guide them through the ever-increasing complexities associated with regulatory change and the associated operational requirements.

If you have any queries, please liaise with your usual Marbury contact or info@marburys.com.

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