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C H A N C E

Client briefing
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21 today; more Chapter 21 listings predicted in Hong Kong

On 6 January for the first time in over 6 years, a Chapter 21 fund was listed on the main board of the Stock Exchange of Hong Kong (the Exchange).

Fund managers have been interested in Chapter 21 listings for some time now and with this recent successful listing, more such listings are likely to follow.

Chapter 21 listed funds allow fund managers to offer professional investors a fund product with the benefits of the regulation of exchange listed products, without the level of restrictions on fund managers under the retail focused alternative presently available.

In this briefing, we explore the background of funds listed pursuant to Chapter 21 of the Listing Rules of the Exchange (Listing Rules).

Key Issues

Background

The Listing Rules provide two avenues for the listing of funds on the main board of the Exchange, namely Chapter 20 and Chapter 21.

Under Chapter 20 of the Listing Rules, only funds which have first been authorised by the Securities and Futures Commission (SFC) as a 'collective investment scheme' pursuant to section 104 of the Securities and Futures Ordinance (the SFO) may be listed on the Exchange. After listing, the fund remains subject to all of the investment, borrowing and other restrictions of the SFC's Code on Unit Trusts and Mutual Funds (the Code) in addition to applicable Listing Rules. Excluding REITs, all but one of the funds presently listed under Chapter 20 are open ended and are available to both retail and professional investors. Examples include Hong Kong's many Exchange Traded Funds (ETFs).

In contrast, a fund listed under Chapter 21 need not be authorised by the SFC and therefore does not need to comply with the requirements and restrictions in the Code. However, because a Chapter 21 listed fund is not authorised by the SFC in accordance with the Code, it cannot be offered or marketed to the public in Hong Kong.

Key features

As compared to a Chapter 20 listed fund, a Chapter 21 listed fund has only two key investment restrictions, namely:

- the fund must maintain a 'reasonable spread of investments'. Generally this will mean that the value of investments in any one company or body held by the fund shall not exceed 20 per cent of the fund's net asset value at the time the investment is made; and
- the fund cannot, either on its own or in conjunction with any connected person, take legal, or effective, management control of underlying investments, and in any event the fund cannot own or control more than 30 per cent of the voting rights in any one of its investments.

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The fund may add any additional restrictions it chooses, but for a period of 3 years after initial listing, the fund cannot change its investment objectives, policies and any additional restrictions (i.e. excluding those above) without first obtaining shareholders' consent.

Other key features of Chapter 21 listed funds include:

- they can be structured as either open or closed-ended funds;
- the fund may not be offered to the public in Hong Kong and upon listing the fund must have a minimum of 300 shareholders all of whom the fund is satisfied are 'professional investors' (as defined in Schedule 1 of the SFO);
- the minimum board lot size of the fund's shares is HK$100,000 with a minimum initial subscription size of HK$500,000;
- the directors of the fund, the fund manager and/or investment adviser must demonstrate that they have satisfactory experience in professional management of investments on behalf of third-party investors;
- applicants can be either newly incorporated or existing funds, as long as they comply with the Listing Rules;
- in the case of a newly formed fund, upon listing the fund no person shall control 30 per cent or more of the voting shares in the fund;
- without a six month lock up, the fund's offering document must be Companies Ordinance compliant, and registered with the Companies Registry;
- while many of the Listing Rules and requirements for an applicant fund are modified by Chapter 21 (e.g. management need not be in Hong Kong, lower notifiable transactions requirements, differing content requirements of accountant's reports), the majority of the key requirements for listing of equity securities also apply to a fund;
- the sponsor of the fund need not be independent of the fund manager and/or investment adviser;
- a third-party custodian must hold the fund's assets;
- shares in the fund will be Hong Kong stock for the purposes of stamp duty requirements; and
- Hong Kong profits tax may be chargeable if the fund is carrying on a business in Hong Kong.

Looking forward

In light of this drought breaking Chapter 21 listing, it appears the Exchange may be receptive to approving such future applications. Conceptually shares in the fund could even be denominated in RMB. Perhaps the key challenge to any successful future application remains the satisfaction of the 300 'professional investor' shareholder requirement. However, this recent listing appears to suggest that professional investors are attracted to the benefits of an exchange listed fund that can be managed without the restrictions on fund managers of SFC authorised funds.

Clifford Chance advised CITIC Securities International Investment Management (HK) Limited on the establishment and listing of China New Economy Fund Limited (HK:00080), the first listing of an investment company under Chapter 21 of the Listing Rules since 2004.