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INSIDE THIS ISSUE…

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Nurturing Hong Kong as an Asian hub

By A. Paris

As the investment industry continues to face a low interest rate environment and the appetite for private capital persists, the Hong Kong asset management industry is well-placed to benefit from the drive to diversify and broaden allocations across Asia. And although some industry commentators point to further progress needed, the legislative changes and supportive environment being fostered represent a huge leap ahead in the jurisdiction's competitiveness.

Last year saw Hong Kong introduce a number of legislative reforms, namely the introduction of the Limited Partnership Fund (LPF) regime, amendments to the existing Open-Ended Fund Company (OFC) regime and reforms to change the tax treatment of carried interest.

The changes to the OFC regime, which came into effect in September 2020 removed all investment restrictions on these structures and enables Type 1 licensees to act as their custodians. The main thrust of these amendments is to encourage Hong Kong's growth as a leading financial hub in Asia.

This was further strengthened through a budgetary measure announced in February 2021 which stated asset managers are eligible to subsidies of up to 70 percent of expenses paid to service providers of OFCs set up in or redomiciled to Hong Kong within the next three years.

In the view of Lewis Lu and John Timpany at KPMG: "In light of all of the recent tax developments in fund management, Hong Kong SAR should have a regulatory and taxation fund regime that is compelling and one that entices Asia-focused funds to domicile themselves in Hong Kong SAR.

"The budget announcements further cement Hong Kong SAR's status as Asia's leading international private equity and asset management hub and will further attract talent and professional services to the region."

> To enhance the competitiveness of the city's ESG investment market, Hong Kong regulators have been gradually introducing more disclosure and reporting requirements in recent years.
>
> Alternative Investment Management Association

Mainland China engine

Industry experts expect a significant amount of business to come from managers in mainland China. A report published by the Hong Kong Investment Funds Association (HKIFA) and KPMG says: "The last few years have seen a significant amount of change in mainland China as its financial services industry and capital markets open up to international investors.

"The scrapping of foreign ownership caps on fund management companies this April presents a welcome opportunity for international firms, while plans to launch a 'GBA Wealth Management Connect' scheme will enhance the cross-boundary flow of financial products between mainland China and Hong Kong."

The industry in Hong Kong has been on a growth path. According to statistics from the Securities & Futures Commission of Hong Kong (SFC) asset management in the jurisdiction registered strong growth in 2019, with a 20 percent year-on-year increase in AUM to HKD28,769 billion and net fund inflows of HKD1,668 billion. This rise took place before the regulatory changes, therefore the outlook going forward is brighter.

The GBA scheme is expected to be part of this future. "Connecting with Hong Kong, an established global financial centre, allows the region [GBA] to immediately tap into its world-class talent pool, sound legal framework and international best practices to help accelerate China's plans to liberalise its financial markets," observes Andrew Lo, Invesco's Senior Managing Director and Chief Executive Officer Asia-Pacific, in a report called 'China asset management at an inflection point'.

In the same report, Cheah Cheng Hye, Co-Chairman and Co-Chief Investment Officer, Value Partners and James Fok Strategic Adviser, London Metal Exchange (LME) say Hong Kong's role as a bridge between China and international markets looks set to endure.

The HKIFA-KPMG survey finds respondents in Hong Kong agree that mainland China remains a key growth market for the industry. A significant percentage of survey participants (79 percent) expect their total AUM originating from China to grow by more than 10 percent in the next five years.

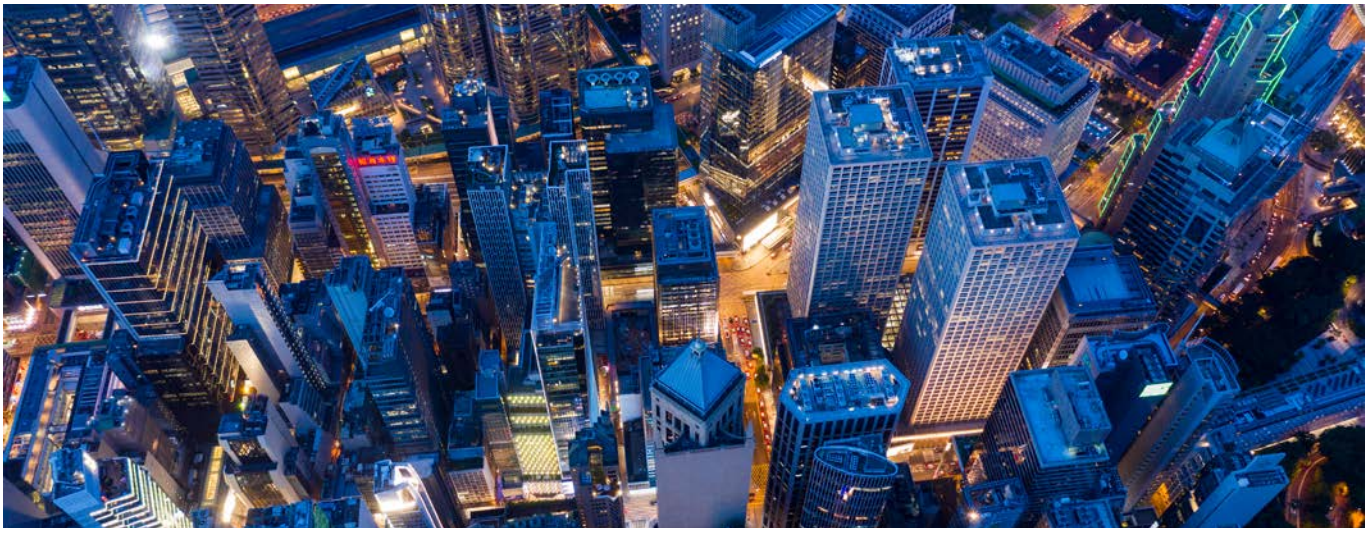
Hong Kong catching up on ESG

Sustainability is another topic addressed within the association's study. "A key development in the asset management industry is the increasing demands from investors that asset managers integrate ESG into their investment decisions and offer more sustainability-related products. Specifically, investors – both institutional and retail – are increasingly expecting their managers to target positive and measurable ESG outcomes, while generating positive financial returns," the study outlines.

Although Europe has largely been leading the charge on sustainability, Asia is coming up the ranks. The HKIFA-KPMG survey reveals around a quarter expect more than 25 percent of their AUM to be invested in ESG products by 2025. A further 16 percent believe their AUM levels here will be between 16 percent and 30 percent.

In December, the HKMA and the SFC became members of the European Commission's (EC) International Platform on Sustainable Finance (IPSF) which encourages private capital to make environmentally sustainable investments. The regulators also actively participate in the Network of Central Banks and Supervisors for Greening the Financial System and the United Nations Sustainable Stock Exchanges Initiative Advisory Group.

The Alternative Investment Management Association recognises the efforts Hong Kong regulators are making in this regard: "To enhance the competitiveness of the city's ESG investment market, Hong Kong regulators have been gradually introducing more disclosure and reporting requirements in recent years." ■



Hong Kong gains traction among Asian investors

Interview with Johnson Har

As Asian investors demonstrate a growing appetite to allocate to alternative investment funds, Hong Kong is becoming more attractive to managers looking to make the most of the opportunity.

"We see significant opportunities for international investors here in Hong Kong. Investors do need to allocate capital to this part of the world in order to diversify their portfolios," explains Richard Jiangdong Hu, managing director, Everbright Overseas Infrastructure Investment Fund. "Supporting managers like Everbright in Hong Kong is beneficial to investors and the industry overall. A group like ours has the advantage of mastering the rulebooks both on the international front and in mainland China."

He outlines how the fund is making good progress in its investment in the Boreal Group – a Norwegian transportation solution provider: "The business has been successfully run, gaining meaningful market share during our ownership, and given its main business of public transportation is an essential service, it has not been affected by Covid-19 to a serious extent. We already have a number of buyers interested in this resilient business."

The fund has a strong track record in this regard. In December 2020, it sold its 100 percent ownership of Tirana International Airport SHPK, with an eye-catching return when global air traffic had ground to a halt as a result of Covid-19. The original investment was made in 2016 and over the course of the holding period, the fund successfully increased the operator's profit by over 50 percent by 2019.

From the perspective of a service provider, Johnson Har, head of Hong Kong at Alter Domus, outlines: "Among Asian limited partners (LPs) and institutional asset owners, we're seeing greater appetite for investing into alternative funds. We're also seeing bigger tickets and names we haven't seen before, which is encouraging.

"Historically, when it comes to alternative investments, the appetite of Asian institutional investors has been lagging behind those in Europe and the US. However, this is increasing and it's a good sign for the industry that Asian institutional investors are going to increase their allocation to alternatives, following in the footsteps of their US counterparts."

Traction for Hong Kong funds

Discussing the attractiveness of Hong Kong as a financial jurisdiction, Har notes: "We are starting to see traction in Hong Kong's Limited Partnership Fund Regime (LPF). Also, once managers launch an LPF and run it well, it will give others the confidence to follow suit. LPs also need time to understand the new LPF regime.

"Hong Kong is a key asset management jurisdiction. Various regulations have come into effect in the past two years and most managers are interested in learning more. It might not be the right fit for everyone, but many are taking an interest."

This is even more relevant given the brief tax blacklisting of the Cayman Islands in 2020. Historically most funds managed by Asian managers have been Cayman-domiciled funds and although the jurisdiction was later removed from the blacklist, some hesitance may remain among investors.

However, there is still progress to be made. According to Hu, "There are certain areas which the Hong Kong government needs to focus on. For example, although it is the third largest international financial centre after New York and London, M&A transaction volume in Hong Kong is still low. There is a tremendous potential to add more depth and sophistication to Hong Kong's investment management industry."

Regardless, the outlook for Hong Kong remains positive. Har says: "We're continuing to see very strong momentum in Hong Kong. All in all, the industry looks very healthy from a Hong Kong perspective and the outlook for new managers and GPs setting up here is strong. We are also seeing global managers entering the Hong Kong market as well as a fairly healthy flow of mainland China asset management companies setting up a Hong Kong team or setting up private structures which will require administrators to provide a cross-jurisdictional service."

Launch decisions

When it comes to launching a fund, Har acknowledges the mammoth task managers face: "We are aware that launching a fund is very difficult and it gets increasingly difficult when you consider the different private structures managers could use. The structure of the fund is an essential item they need to take into account when looking to set up a new fund."

Everbright is also mulling over options. Hu says, "We are planning to launch our second infrastructure fund this year. Though we will continue to keep an eye on Europe, we envisage this fund will focus more on investments in Southeast Asian countries. We are currently speaking with potential investors, including major financial institutions in the region. This is what we're currently busy working on." According to Hu, investor base and investment destinations, together with other considerations like regulations, tax and reputation of jurisdictions, will drive the structure of the fund.

Johnson Har
Head of Hong Kong SAR, Alter Domus

Johnson Har joined Alter Domus in 2018 as Head of Hong Kong SAR. He is responsible for managing Alter Domus' Hong Kong office and driving the continuous growth of Alter Domus' business in Hong Kong. Har has over twenty years of experience in the financial services industry across the US and Hong Kong, and completed his university education in the US and his MBA in Hong Kong.

Har also stresses the importance of managers performing an exercise in self-assessment: "They need to focus on the various regulatory reporting requirements, some of which are new. The process of setting up a new fund gives managers the opportunity to take stock of their internal resources and see whether they have sufficient administrative professionals across different parts of the business such as regulatory and compliance reporting, along with increasing LP requirements. They can take this time to consider whether there are any functions they need to outsource."

Sticky relationships

The question of outsourcing can be critical to the success of an alternative investment fund. For Everbright, the support of their partners provides stability. Hu elaborates: "We value and treasure our longstanding relationship we have with our service providers. We see them as trusted advisors and have very little desire to make changes in this regard. There are different cultures, rules and communication at play, and we need to make sure we understand each other well. Therefore, our relationships with service providers tend to be sticky."

Further, these providers support managers' drive to expand their business and to keep up to date with the developments in the international investment management industry.

Hu comments: "Hong Kong is a small territory and we need to understand what's going on in Europe, the US and the rest of the world. We want to know about trends in investor appetite, new regulations, new business models and value chains. This is information vital to our survival and separates us from mediocrity.

"Service providers support our plans and help putting them into action. For example, if tomorrow we acquire an asset in Malaysia, we need support to fulfil the local government's requirements for that transaction. When we made the investment in Norway, we hired some corporate service providers to help us manage the tax vehicles. The different firms we work with provide us with specific services depending on where their strengths lie. A fast one-stop service is always preferable, but we need to make sure there are the necessary firewalls and compliance requirements in place for that to work effectively." ■

Richard Hu
Head & Managing Director, China Everbright

Richard Hu joined Everbright Overseas Infrastructure Investment Fund during its vintage in 2016 as MD and Head. Prior to joining the Fund, he had over twenty years of investment and managerial experience serving in major financial and commercial conglomerates and listed companies across Hong Kong, mainland China and the US. Hu completed his college education in China and his MBA degree in US.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Appetite for diversification to underpin HK progress

Interview with Richard Chou

Hong Kong recently introduced regulatory reforms, policies and incentives to drive growth and increase Hong Kong's attractiveness as a fund domicile. The newly adopted Limited Partnership Fund Ordinance (LPF) bill allows Hong Kong's private equity firms to launch limited partnership funds. Already, there are signs that firms are taking advantage of the market to innovate.

As China's asset management and broader financial services industry continue to grow and attract interest, there is an opportunity for managers in Hong Kong to reap the benefits of the growing wealth on the mainland. Richard Chou, Vice President of Business Development APAC for SS&C Advent, sees a significant uptake of requests for limited partnerships among clients.

"Hong Kong will be able to take advantage of the growing wealth in both Hong Kong itself and China," comments Chou. "Because of this, more and more products and funds will be required to service the ever-increasing wealth in Asia."

Managers are broadening their fund portfolios following the adoption of LPF. Many are planning to launch several funds from a single umbrella structure. "A lot of our managers are using umbrella structures intending to spin out multiple funds. This positive development means the manager is not just relying on one fund. Managers are then able to provide investors with a variety of choices of funds," says Chou.

In 2018, Hong Kong's Securities and Futures Commission provided the option for open-ended investment funds to be structured in a corporate manner rather than as unit trusts. The regime aims to enhance market infrastructure to support the jurisdiction's growth as an international finance centre.

Global asset allocation and domestic investment will drive Chinese managers to set up in Hong Kong. "Most Chinese managers would choose Hong Kong as their offshore headquarters because it is one of the world's financial centres and part of China. Historically, they could only select the Cayman or BVI structure as there were no laws or regulations for the managers to manage onshore assets in Hong Kong," Chou notes.

Setting up a private equity fund in Hong Kong can be more cost-effective for Chinese managers and bolster confidence for their investors. "They would feel much more comfortable wiring money to a Hong Kong cash account with the fund also registered onshore," Chou says.

To succeed, Chou believes Chinese asset managers should understand the local regulation and how to manage an overseas entity based on overseas rules and policies.

Chou says the outlook for Hong Kong funds is very positive: "There are 10,000 managers in China, and many of them will want to set up in Hong Kong to diversify their assets, AUM and investor base. In addition, the industry has become a lot more professional in the last 20 years. Hong Kong offers a wide choice of hedge funds and private equity funds for investors to choose from." ■

Richard Chou
Vice President of Business Development, SS&C Advent

Richard is responsible for the business development of SS&C Advent for the Greater China market where SS&C Advent is re-positioning itself in the emerging wealth management market with its award winning Advent Global Wealth Solution. Richard has 20 years global product development experience in SS&C Advent's solutions for the wealth management and asset management markets – Advent Investment Suite. Prior to joining SS&C Advent in 2000, he worked in enterprise resource planning systems for Bradley Company (Xerox Corp.) in Cleveland Ohio.

Resumed travel will boost market growth

Interview with Michael Pang

Despite a challenging fundraising environment, the new Limited Partnership Fund Ordinance regulation (LPF) has the potential to make Hong Kong the preferred domicile for investment funds in Asia, especially once travel restrictions are lifted. As investors seek to broaden their portfolios, Asian funds can be a valuable source of diversification.

"We are very excited about the limited partnership fund structure. It gives the market additional flavour and we now have more options to offer our clients and prospects," says Michael Pang, Executive Director, Head of North Asia Alternative Investments, Circle Partners, "The reaction and feedback from the community has been very positive and we expect to see an increase in demand for these structures. As a global fund services provider, we certainly see traction in terms of the number of LPFs set up since the bill passed in August 2020, and we expect the appetite will continue to grow."

In Pang's view, the LPF is a milestone for Hong Kong as an international jurisdiction: "We are very confident in the Hong Kong government's commitment to strengthen its competitiveness and sustain its status as an International Financial Centre, particularly when it comes to building an alternative investment hub in the region.

Beyond travel restrictions

The outlook for growth in alternative funds across Asia as a region is strong. This is despite a challenging fund-raising environment. According to Pang, this environment can encourage managers to be more discerning about the strategy they bring to market: "They need to consider what would most encourage growth. For example, they could restructure their current fund or launch new strategies which align with the limited partners' (LPs) sentiment or expectations. Most investors are looking to diversify their assets so increasing exposure to Asian markets is likely."

However, a few factors make the prospect of tapping into that opportunity more challenging, especially in times of Covid is undoubtedly

challenging. Pang believes launching new fund in this environment is particularly difficult: "Managers are not able to meet investors face to face to demonstrate their track record and value proposition. They have to do it through a virtual call on Zoom or teams, which may not be the most effective way of marketing a fund."

Pang explains how although parts of the region have suffered, the speed of recovery in Asia is looking to be quite high: "We are already seeing a lot of momentum in terms of new funds being launched to take advantage of the new structure. And this is only going to grow."

In this challenging fundraising environment, global alternative AUM on all underlying assets is expected to grow 9.8 percent according to Preqin's report. Pang comments: "We are seeing large portion of private markets/ private assets targeting Asia Pacific and Limited Partners (LPs) are diversifying their asset classes and increasing exposures to Asia Pacific. The attractive and subsidy offerings such as tax incentives, simplified capital raising, segregation of assets and liabilities, will certainly help Hong Kong to best take advantage to secure its position."

Encouraging incentives

The Hong Kong government is working hard, from its vantage point, to increase the attractiveness of what the jurisdiction has to offer. Tax incentives, simplifying capital raising, segregation of assets and liabilities – these are all elements which can help encourage managers to domicile their products in Hong Kong.

In the latest iteration of such initiatives, foreign investment funds can now re-domicile in Hong Kong for registration as an Open-Ended Fund Company (OFC). In its most recent budget speech, the government also announced it will subsidise up to 70 percent of the cost of setting up a new OFC or moving funds to Hong Kong. "These may seem like small things when considered separately but together they can provide significant incentives to attract more people to the investment community here," Pang suggests, "Some of our fund clients are looking into re-domiciliation, driven by these latest updates from the Hong Kong SAR regarding subsidies. More such incentives or subsidies can be attractive to the investment fund community."

Having a base in Hong Kong can be a significant advantage for managers looking to tap into the Asian investor asset pool. It can also benefit their strategy. Pang also highlights the cost considerations managers need to make when considering their fund domiciliation: "Although managers should take into account what structure they are going to use, cost remains a key concern. Once they cater for all the legal, tax and other advisory fees, as well as administration and annual maintenance charges, managers need to make sure their business remains cost effective."

He says managers are also being driven to domicile their funds in Hong Kong due to the assets they are investing in: "For some this is the perfect moment to consider a local Hong Kong domiciled fund given the fact that they will have easier access to what they're investing in. As a global fund service provider, we are agnostic on where managers are domiciled and what structures they use. Ultimately, we advise them to make the decision which is in the best interest of their investment strategy and their investors." ■

Michael Pang
Head of North Asia, Alternative Investments, Circle Partners

Michael Pang is the Head of North Asia Alternative Investments of Circle Partners, he is responsible for driving business and growth strategy in North Asia, particularly Greater China. Michael has over 17 years of experience, he held senior management positions in market leading financial services companies in the private equity, capital markets and M&A arena. Prior to Circle Partners, Michael worked for global fund services provider, he has extensive experience working with clients such as hedge fund, private equity/ venture capital and private debt fund. Michael speaks native Mandarin, Cantonese and English.

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