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Private Wealth

Hong Kong: Trends & Developments

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Trends and Developments

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Opportunities in an Uncertain Time

Introduction

The theme that dominates the year 2020 is change and challenges in an uncertain world. At the time of writing, the world is facing the biggest public health crisis of the century, and though the battle is not over, Hong Kong demonstrated success in its fight when it was one of the earliest places to navigate all the unknowns and fears of the new coronavirus; COVID-19. This should give some confidence in Hong Kong's resilience, even as Hong Kong faces fresh questions on its long-standing position as the bridge between China and the world, and as a city with rich traditions and characteristics of the East as well as the West.

Significant changes in Hong Kong

As with everywhere, private wealth advisors and clients have adapted to the new normal of an increasingly transparent world of FATCA and the common reporting standard, which makes robust and effective planning even more important and necessary. While this is the new normal in the world of private wealth planning, Hong Kong is confronting its own unique uncertainties but its unique role remains key and continues to evolve alongside the changes and developments of China's economic and financial markets, while at the same time finding its place along with Mainland China in a new geo-political order of a rising China.

The past year has seen Hong Kong withstands and persists through unprecedented displays of civil protest, social division and unrest. However, the city continues to operate in strength, while the government seeks new ways to understand civil society concerns and address grassroots issues. China has now introduced the National Security Law for restoring security, peace and stability, although this has raised controversy and questions on Hong Kong's promised autonomy, with the United Kingdom opening a new path to citizenship to 3 million Hong Kong residents who are holders of British National (Overseas) passports, including their spouses or children, and other countries voicing similar concerns and offering residency to Hong Kong people.

Jitters aside, the Hong Kong government and financial regulators have emphasised that the new law is for Hong Kong's long-term prosperity and is not intended to affect the legitimate rights and freedoms or the rule of law of its common law legal system,

and reassured that there will be no change to the fundamentals of Hong Kong's monetary and financial system or the normal conduct of business or capital market activities.

COVID-19

Recent events are sobering and awaken advisers and clients to the importance of preparedness and resilience to face risks, crises and uncertainties, as well as the advantages and limitations surrounding residency. With the new reality of travel restrictions, for private clients the advantages and limitations of citizenship and residency become clear, and some may find their actual residence for extended periods up-end earlier planning.

The silver lining is that there has been an explosion of philanthropic initiatives directed towards COVID-19 relief efforts, including emergency health care responses, as well as meeting the needs of those hit hard by the difficult and unusual economic circumstances due to COVID-19. At the same time there are calls for a hard look at our society's values and purposes and for more funding and capital to build back better post-COVID-19.

This is propelling a strong momentum for environmental, social and governance (ESG) considerations in both public and private companies and markets, and those who are proactive in impact investing and seeking positive impact in line with the United Nations Sustainable Development Goals (UNSDG). There are also increasing interest and scope for more private clients who are entrepreneurs and high-net-worth individuals/families to engage in philanthropy, either through family foundations or charitable giving, as well as engaging in impact investments.

While this is the complex and dynamic backdrop that confronts Hong Kong as it further develops as a private wealth centre, private wealth advisors and their clients would do well in seeking out the opportunities amidst the uncertainties.

Regional financial and wealth management centre

Hong Kong has always risen to challenges and found opportunities to thrive, and in this dynamic and changing environment, as private wealth advisors, opportunities can be identified for the industry and private wealth clients.

With its deep market infrastructure, highly established and liquid markets, and expertise in international finance, Hong

Kong is expected to remain strategically important in China's "opening-up" and integration with the global financial markets. Under "One Country, Two Systems", Hong Kong's common law legal system, unrestricted foreign exchange and capital flows and dollar-peg currency all offer a well-oiled operating environment for international and Chinese companies and institutions to tap cross-market opportunities relating to China as the second largest economy in the world.

A top global market

Hong Kong is home to one of the top three global markets for initial public offerings, and US-China tensions have resulted in more Chinese companies choosing to return to or list in Hong Kong. Hong Kong is also increasingly a significant centre for China and Asia venture capital and private equity activities. The strength and vibrancy of both the public and private markets have drawn financial institutions and institutional investors, while private banks and financial advisory firms including multi-family offices are increasingly drawn to Hong Kong to meet the investment needs of growing wealth in China and the region.

Hong Kong has a well-established asset management and funds industry that has been successful under its dynamic and free markets, while global asset managers operating in Hong Kong continue to have unique opportunities due to the region's close and strategic links to China's growth. Under an open architecture framework, fund managers with overseas qualifications and experience of other markets may qualify to set up as licensed managers or intermediaries in Hong Kong and, furthermore, Hong Kong is domicile-neutral on the funds that may be offered in Hong Kong on a private placement basis or which may be approved for offer to the public in Hong Kong. Against this backdrop, Hong Kong continues to see many asset management or marketing offices set up here by international global fund houses and, in recent years, more market entrants from Mainland China and other parts of Asia.

A vibrant and expanding fund management industry in Hong Kong offers growing availability of financial products and investment choices for private wealth management and close direct access to professional investment expertise in a highly regulated environment.

Greater Bay Area

Hong Kong's position as a key international financial centre is expected to be further consolidated under China's Greater Bay Area plans, to leverage Hong Kong's status as a key international financial centre and offshore Renminbi hub, and as an international asset management centre. The Hong

Kong Monetary Authority, the People's Bank of China and the Monetary Authority of Macao have jointly announced a pilot cross-border wealth management connect scheme for the Greater Bay Area of Guangdong-Hong Kong-Macao, intended to be a framework for wealth management and investment services to be available to meet the needs of residents within the Pearl River Delta region of Hong Kong, Macau and nine cities in Guangdong province, including Shenzhen.

While details of the wealth management connect scheme are uncertain and still to be issued, the potential could be immense, with the Greater Bay Area becoming a catchment area for banking and wealth management products and services to a population of more than 70 million and expected to be an economic and financial power centre with the highest density of ultra-high net worth individuals around the world.

Hong Kong as a family office hub

The Hong Kong Financial Services Development Council (FSDC) has published a policy paper in July 2020 on developing Hong Kong as a regional family office hub, leveraging on growing wealth in China and Asia, and on Hong Kong's mature and sophisticated financial markets infrastructure.

Hong Kong's relatively low tax rates and friendly tax framework make it an attractive location not only for income and wealth generation, but also as a centre through which wealth and assets are held and managed. Hong Kong has established itself as a successful and prominent centre for asset management and financial services and is increasingly a significant market in offering trust and wealth management services to high-net-worth and ultra-high-net worth families in the region, including from Mainland China and other countries in Asia with emerging wealth.

While Hong Kong is already home to many sophisticated finance professionals, in recent years Hong Kong has made more efforts to enhance the qualifications and expertise of its wealth management professionals. A Task Force chaired by the Hong Kong Monetary Authority (HKMA) and comprising representatives from the Private Wealth Management Association (PWMA), The Hong Kong Institute of Bankers, Hong Kong Securities and Investment Institute and Treasury Markets Association introduced an Enhanced Competency Framework (ECF), sets out an enhanced level of competency expected of relevant practitioners in the private wealth management industry and offers professional qualifications as certified private wealth, investment or trust professionals.

Although the ECF is a voluntary scheme, it reflects the efforts of the industry bodies in Hong Kong to further develop the

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competency and expertise of private wealth management professionals in Hong Kong, especially those who offer banking, dealing, advisory or portfolio management services to private banking customers.

Regulatory consideration of investment businesses

While there are no laws or regulations that refer specifically to family offices, the actual nature of activities may trigger certain regulatory issues, particularly where an office is carrying on business involving investing or trading in securities or futures that may amount to regulated or licensable activities.

As clarified by the SFC in its Circular on the Licensing Obligations of Family Offices issued in January 2020, single family offices may rely on the licence exemption for providing asset management services solely to related entities, which is an existing exemption for providing services to wholly-owned subsidiaries, its holding company holding all its issued shares, or the wholly-owned subsidiaries of its holding company. Multi-family offices that provide services beyond such related entities would likely be subject to licensing requirements.

Broadly speaking, the nature of the activities undertaken would determine the type of licence or categories of regulated activities that may need to be approved by the Hong Kong Securities & Futures Commission (SFC), the primary regulator on the conduct of securities and futures businesses and markets in Hong Kong. A licence to conduct the regulated activity of “asset management” is required for engaging in fund management and/or investment management of portfolios investing in securities or futures contracts. However, the offering of investments or fund products may fall to be licensed for the regulated activity of “dealing in securities”, although a licensed fund manager may be exempted when offering its funds pursuant to its conduct of licensed asset management business.

It is increasingly common for managers and intermediaries to be licensed with the condition to only provide their services to “Professional Investors” – this covers institutional investors on the one hand, and on the other hand high net worth individuals or corporations that meet the relevant wealth or assets thresholds. Generally speaking, there are no registration requirements specifically for funds to be offered only on a private placement basis, unlike funds to be offered to the public in Hong Kong which need to be separately authorised by the SFC, and the fund manager would need to be subject to further qualification requirements for managing an authorised fund.

Under the Securities & Futures Ordinance (SFO), Hong Kong has a private placement framework that permits limited offers in Hong Kong and allows unlimited offers to be made to “Professional Investors” as defined under the SFO. Broadly, there

are three main categories of Professional Investors: Institutional Professional Investors, such as financial institutions and specific bodies as prescribed in the legislation, and Individual Professional Investors or Corporate Professional Investors that meet the relevant minimum net worth or net assets requirements (being individuals with a portfolio of at least HKD8 million, or a corporation or partnership with a portfolio of at least HKD8 million or net assets of HKD40 million).

Trust companies and trust business

Hong Kong’s main trust legislation was updated in 2013, and the revised Trustee Ordinance introduced provisions to bring it more in line with the developments in other common law jurisdictions to make Hong Kong a more attractive domicile for setting up trusts.

Besides abolishing the rule against perpetuity, the validity of reserved power trusts has been clarified in statute - that a trust would not be invalidated merely due to the settlor reserving any or all of the powers of investment or asset management functions under the trust, and that a trust who acts in accordance with the exercise of the power or function as reserved by the settlor is not in breach of the trust. The Trustee Ordinance also stipulates that foreign forced heirship provisions shall not affect the validity of inter vivos transfer of any movable property to a Hong Kong law trust and Hong Kong trustee, where the settlor had the capacity for the transfer under the law applicable in Hong Kong, the law of their domicile or nationality or the proper law of the transfer.

Trusts and duty of care

Under the revised Trustee Ordinance, trustees of Hong Kong law trusts are now subject to a statutory duty of care - to exercise such care and skill as is reasonable in the circumstances, having regard in particular, to any special knowledge or experience that the trustee has or claims to have, and if the trustee is acting in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession. At the same time, the legislation provides that the standard may be modified or excluded by express provision in the trust’s governing instrument. Subject to the appropriate duty of care, trustees have the power to delegate and appoint agents, and also that trustees may insure against risks and receive remuneration, including reasonable remuneration for services provided by professional trustees (even if the entitlement to remuneration is not provided under the trust instrument).

Regulation of trust companies or trust business

More trust companies are being established in Hong Kong to conduct trust services business, meaning to act as corporate

trustee of multiple trusts and charge remuneration for doing so, subject to being approved as a licensed trust and corporate services provider (TCSP) as required since 2018 under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance, and pursuant to which there are strict requirements on customer due diligence and record-keeping. There is no minimum capital requirement for TCSP licence, but separately, to become a registered trust company under the Trustee Ordinance and to become eligible to act as a trustee for certain trust arrangements (for example as trustee or custodian of mandatory provident fund schemes or SFC-authorized retail funds as prescribed under applicable law or regulations) or as corporate executor of a will, there is a minimum capital requirement of HKD3 million to be issued and fully paid up in cash, and HKD1.5 million must be deposited with the Government's Director of Accounting Services or a bank guarantee must be issued to the Government for the same amount. The objects of a registered trust company are limited to some or all of the statutorily prescribed objects set out in the Trustee Ordinance. The HKMA has launched a consultation to review and further enhance the regulation and supervision of trust business, particularly the conduct of trust business by banks for wealth management purposes. The consultation paper, published on 10 July 2020, contains proposals for a regulatory code on the conduct of trust business and provision of trust services, with the intention to enhance protection of client assets held on trust and better align with international standards and practices, to promote treating customers fairly and customer-centric culture in trust business. The proposed Code of Practice for Trust Business ("Code for Trust Business") shall apply to all banks or authorised institutions under the Banking Ordinance that conduct trust business in Hong Kong, while other trustees that conduct trust business in Hong Kong are encouraged to adopt to the extent applicable.

It can be anticipated that the Code of Trust Business should serve to further promote Hong Kong as a well-regulated centre for private trusts and wealth management for the benefit of private clients. Comments on the draft Code for Trust Business are invited to be submitted by 9 November 2020.

Onshoring of trust and investment activities

The growth of trust companies in Hong Kong is seen as part of a trend of the "onshoring" of trust and investment activities. Traditionally, whether in the conduct of family-owned businesses or trust structures using offshore companies for the holding of investments or real properties, or for investment management, it has been common to use entities in jurisdictions with no tax or nominal tax, such as the British Virgin Islands or the Cayman Islands. Under the "Resumption of Application of Substantial Activities Factor to No or only Nominal Tax jurisdictions" issued by the Organisation for Economic Co-operation and

Development (OECD), since 2019 the introduction of economic substance requirements in such traditional no or nominal tax jurisdictions has resulted in a review of most of the entities established in such jurisdictions, either to consider and comply with the relevant new requirements for real or adequate substance, or to adopt substance, operations or residency in an alternative, onshore, jurisdiction, depending on the location of the individuals who are directors or decision-makers, place of administration or relevant employees, office premises or set-up in any business or income-generating activities undertaken in the relevant jurisdictions.

Such "relocation" of activities or entities to an "onshore" jurisdiction continues and, as Hong Kong has a friendly tax regime and is not on the European Union's blacklist of non-co-operative jurisdictions, it presents a viable option. It should be noted that Hong Kong operates a territorial basis of taxation, where any entity operating in Hong Kong may, in principle, be subject to tax in Hong Kong on any Hong Kong sourced income from carrying on a trade or business in Hong Kong, and the potential tax implications that may arise should be considered.

It is also worth noting that, generally, the Inland Revenue Department (IRD) may issue a "Certificate of Resident Status" (ie, a tax residency certificate) to a company that is incorporated in a no or nominal tax jurisdiction if it can be proven to the IRD's satisfaction that the company in question is normally controlled and managed in Hong Kong. As such, the above-mentioned relevant entities incorporated in a no or nominal tax jurisdiction may become eligible for Hong Kong's network of agreements for the avoidance of double taxation (DTAs), subject to establishing its tax residency in Hong Kong. With that, similar to Hong Kong incorporated companies, entities incorporated in a no or nominal tax jurisdiction can potentially also enjoy tax treaty benefits (eg, reduced withholding tax rates with respect to the receipt of overseas dividends, interest and royalties, as well as protection against capital gains tax in the relevant investee country), provided that the relevant conditions are satisfied.

Tax transparency and the Common Reporting Standard

Hong Kong has kept up with the latest global standards on tax transparency. It is not necessary for a country to conclude a DTA with Hong Kong before it is able to submit an exchange of information request, and Hong Kong follows the OECD Model for stand-alone tax information exchange agreements (TIEAs). In terms of scope of the exchange of information, there is no difference in substance between a TIEA and the exchange of information article in DTAs. So far Hong Kong has concluded TIEAs with seven jurisdictions, and DTAs with 43 jurisdictions.

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Hong Kong has entered into a Model 2 intergovernmental agreement (IGA) in connection with the Foreign Account Tax Compliance Act (FATCA), under which financial institutions in Hong Kong are obliged to report information on their US clients and relevant transactions directly to the US Internal Revenue Service. Furthermore, in 2016 Hong Kong adopted the new international standard for the automatic exchange of financial account information in tax matters – ie, the Common Reporting Standard (CRS) promulgated by the Organisation for Economic Co-operation and Development (OECD) – and in 2017 enabled its participation in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and also amended the IRO to implement the CRS.

With tax transparency and frameworks for exchange of information well established, it is important for proper planning and advice to be sought on the tax implications of citizenships and multiple residencies, and cross-jurisdictional ownerships of businesses and assets.

Immigration schemes

Given Hong Kong's low tax rates (15% personal income tax rate), and its vibrant business and financial markets, Hong Kong is still an attractive option for private clients who may wish to consider setting up residence here, which may be for running or expanding family business, or operating a family office for managing and investing family wealth. Broadly speaking, unless otherwise eligible or having a right of abode, an individual who has been residing in Hong Kong for a continuous period of not less than seven years may apply to become a permanent resident.

The Capital Investment Entrant Scheme (CEIS) was put in place to facilitate entry for residence in Hong Kong by persons making capital investment in Hong Kong of at least HKD10 million (the last investment threshold prior to the suspension of the scheme), and without a requirement for running a business in Hong Kong, however the CEIS has been suspended by the Hong Kong Government from 15 January 2015 until further notice.

Meanwhile high-net-worth individuals may consider applying for investment as entrepreneurs, subject to meeting the requirements. The criteria to be considered by Hong Kong immigration include whether the applicant is in a position to make a substantial contribution Hong Kong's economy, with consideration factors including, but not limited to, business plan, business turnover, financial resources, investment sum, number of jobs created locally and the introduction of new technology or skills. The Immigration Department will consider whether the capital investment amount is able to support the operation of the business. An applicant who wishes to establish or join in a start-up business may also submit an application.

The Immigration Department may consider the application favourably, especially if the start-up business concerned is supported by a government-backed programme with a rigorous vetting and selection process, and the applicant is the proprietor or partner of the start-up company or a key researcher of the relevant project. Examples of government-backed programmes include:

- StartmeupHK Venture Programme administered by InvestHK;
- Incu-App, Incu-Bio and Incu-Tech programmes administered by the Hong Kong Science and Technology Parks Corporation;
- Cyberport Incubation Programme;
- Small Entrepreneur Research Assistance Programme and Enterprise Support Scheme administered by the Innovation and Technology Commission; and
- Design Incubation Programme administered by the Hong Kong Design Centre.

Other programmes for residence visas in Hong Kong are the Admission Scheme for Mainland Talents and Professionals (available for Chinese residents of Mainland China who possess special skills, knowledge or experience of value to and not readily available in Hong Kong), and the Technology Talent Admission Scheme (during the three-year pilot scheme), other than general employment visa applications under the Hong Kong General Employment Policy.

In order to enhance Hong Kong's economic competitiveness, Hong Kong has introduced the Quality Migrant Admission Scheme, targeting highly skilled or talented persons who wish to settle and work in Hong Kong, being those covered by the first Talent List of Hong Kong and who meet relevant requirements. There is also an admission scheme for the Second Generation (ASSG) of Chinese Hong Kong Permanent Residents, aimed to attract applicants who are the second generation of emigrated Chinese Hong Kong permanent residents from overseas to return to work in Hong Kong. Unlike the former employment visas, applicants of these two schemes do not need to secure an offer of local employment upon application, before they reside and work in Hong Kong.

Growth of sustainable finance and impact investments

Hong Kong offers opportunities for further growth as a centre for venture capital and private equity conducive to incubating, investing and growing start-ups in the region, is one of the largest markets for capital raising and initial public offering, and there are tremendous talents in the city as a centre for managing and investing "first generation wealth", including to further build and expand on the family's business empire and legacy.

There is growing emphasis on values and purpose, with research suggesting that a significant percentage of high net worth individuals today regard social impact as important, especially those under 40, and are active in considering social responsibility in their investments or impact investing. The “new generation” is also increasingly conscious in seeking out positive social or environmental impact in their business endeavours, or establishing social enterprises and/or non-profit entities targeting one or more goals of the UNSDGs.

Charities

Without a charities legislation or charities commission, the only official recognition of organisations with charitable purposes in Hong Kong is the tax exempt status granted by the IRD under Section 88 of the Inland Revenue Ordinance. In September 2019, the IRD issued an extensively updated version of its Tax Guide For Charitable Institutions and Trusts of a Public Character, which provides helpful guidance on the expected regulatory and compliance requirements of the IRD on charities from the tax perspectives. Among other updates it is noteworthy that the IRD stated for the first time that charitable organisations may engage in investment activities to further their charitable objects, although it remains to be seen how this can be applied in practice.

Going forward

Hong Kong is a progressive centre that does not rest on its laurels, but continues to review and keep pace with international developments and standards. In June 2020 the SFC and the HKMA has launched the new Green and Sustainable Finance Cross-Agency Steering Group (“Steering Group”) which signals an exciting milestone for more coordinated approach and actions towards ESG policy-making in Hong Kong. The Financial Services Development Council (FSDC) has also issued its paper the following month, on developing Hong Kong into Asia’s ESG Investment Hub.

Despite challenges and uncertainties, there are reasons abound for confidence that Hong Kong continues to compete and present significant opportunities and tools as a centre for private wealth management.

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Vivien Teu & Co LLP is a Hong Kong corporate and commercial law firm with particular focus on investment funds, asset management and financial services, securities and regulatory, tax and trusts. The firm has been highly rated for technical ability and innovation, with its lawyers having in-depth Hong Kong and international legal practice experience, combined with deep and broad knowledge of China and regional markets. The legal practice areas at Vivien Teu & Co LLP encompass providing corporate and commercial law advice, as well as securities law and financial regulatory advice in local and international transactions, and it is typically a go-to firm for corporate transactions, funds formation and clients

seeking legal and regulatory advice involving Mainland China and Hong Kong elements. The firm has gained a reputation of offering seamless support on cross-border Hong Kong and Mainland China matters in the areas of asset management, investment funds, cross-border securities and investments, inbound and outbound mergers and acquisitions, and China market entry strategies. Besides an enviable corporate and institutional client base including global and regional investment management firms and financial institutions, the firm is also increasingly serving private clients, high net worth entrepreneurs and family offices, in its wider financial services, private wealth, tax and trusts practice.

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Vivien Teu is a corporate and commercial lawyer with a focus in the financial institutions sectors, covering investment management, financial services and other finance, securities and related regulatory matters. Vivien has a wealth of experience in providing strategic advice on legal issues

in the areas of asset management and diverse forms of investments funds formation, structuring of asset management, investments or financing arrangements across asset classes and structures. Vivien's diverse experience also includes advising on joint ventures, shareholder agreements, corporate governance, general corporate and commercial advice, trusts and tax structuring. Vivien has been involved in numerous financial institutions and asset management firms' joint ventures and M&A, and provides legal advice and services to corporates and high net worth individuals on tax and asset-structure planning, establishment of trusts and other arrangements. Driven by a passionate belief in responsible finance and capital, Vivien has strengthened an ESG and impact focus within the firm's practice areas, and is increasingly advising and working with charities, foundations, social enterprises and other impact actors.

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