

## **CHAPTER 16**

### **COLLECTIVE INVESTMENT SCHEME**

#### **Identification of accounts held by collective investment scheme (CIS)**

The definition of investment entity is wide and includes CIS, as well as fund managers, investment managers, fund administrators, transfer agents, depositories and trustees of unit trusts as all of these entities could be investing, administering or managing financial assets of a CIS. However, in any such case, the entity will only have reporting obligations if it maintains financial accounts.

2. Paragraph (c) of the definition has put it beyond doubt that any CIS authorized under the Securities and Futures Ordinance (Cap. 571) (SFO) will fall under the category of an investment entity. Paragraphs (d) and (e) of the definition, however, would be appropriate to a CIS which is not authorized under the SFO. If the CIS is resident in Hong Kong or the non-resident CIS has a branch located in Hong Kong, it will be a reporting financial institution.

3. The only financial accounts that are relevant to CIS are the equity and debt interests in the CIS. An entity within the definition of investment entity, by virtue of investing, administering or managing financial assets of a CIS but which does not itself maintain financial accounts is not required to identify or report the accounts it administers or manages. For example, a transfer agent who provides services to a CIS on a third party basis, would not typically have a direct obligation to identify or report the accounts of the CIS. It may agree to provide additional services to the CIS to assist with the CIS's obligations, but the CIS in this case would be the reporting financial institution with responsibility for compliance with the obligations.

4. Where the interests in the CIS are held directly by the investors, the CIS is the only financial institution that will be regarded as a reporting financial institution in relation to the CIS. Where the CIS's interests are held through intermediaries, those intermediaries are responsible for identifying their own direct account holders.

5. An entity which is regarded as an investment entity and therefore a financial institution solely because it administers or manages the financial assets of a CIS will not be regarded as a reporting financial institution with reportable accounts merely because of its management or administration activities. The definition of financial account excludes equity or debt interest of an advising manager where it is an investment entity solely because it (a) renders investment advice to, and acts on behalf of, or (b) manages portfolios for, and acts on behalf of, a customer for the

purpose of investing, administering, or managing financial assets deposited in the name of the customer with a financial institution other than the advising manager. As such, an advising manager who only provides services to a CIS and does not maintain any financial account on its own, will not normally have any reporting obligations. This interpretation equally applies to fund managers, investment managers, fund administrators, transfer agents, depositories and trustees of unit trusts.

6. Where a CIS is a reporting financial institution, the person responsible for ensuring compliance with the obligations under sections 50B, 50C and 50D of the IRO are as follows:

- (a) For a CIS constituted as a corporation, that corporation and its directors are responsible for ensuring its compliance with the obligations; and
- (b) For a CIS that is not constituted as a corporation, the person who acts for the CIS to maintain financial accounts.

A service provider may be appointed to carry out due diligence and reporting obligations under the IRO. The appointment may be made by the corporation or person who acts for the CIS to maintain financial accounts. To avoid doubt, even if a service provider has been engaged, the corporate CIS or person who acts for the CIS to maintain financial accounts is not relieved from its obligations under the IRO.

### **Platforms and other fund distributors**

7. Fund distributors, which may include financial advisers, fund platforms, wealth managers, brokers (including execution-only brokers), banks and insurance companies, may fall within the definition of investment entity because of their role in distributing a CIS.

8. There are two different types of fund distributors: those that act as an intermediary in holding the legal title to the CIS (i.e. as nominee) and those that act on an advisory-only basis.

9. Where a customer appears on a CIS's register, the responsibility to report on that customer lies with the CIS. However, if a customer invests in a CIS via a fund platform, the responsibility to report may lie with the platform. For example, fund platforms typically hold legal title to interests in CISs as nominees on behalf of their customers (the investors). The customers access the platform in order to buy and sell investments and to manage their investment portfolio. The platform will back

the customers' orders with holdings in the CISs, and possibly other assets, but only the platform will appear on the shareholders' register of the CISs. Where this is the case the platform will be responsible for the reporting on its financial accounts.

10. On the other hand, most but not all financial advisers act in an advisory-only capacity. They advise their customers on a range of investments, and may intermediate between the CIS, or in some cases fund platform, and the customer. However, they will not hold legal title to the assets, instead the customer appears on the share register of the CIS or as a direct customer to a fund platform. Financial advisers acting in this manner will not be regarded as the financial institution that maintains the financial accounts.

11. A platform may have a "mixed business" where it acts as an adviser or "pure intermediary" between the investor and the underlying financial institution on behalf of some customers. In addition, it also holds legal title to interests on behalf of other customers. In the case where legal title is held, the platform will be a financial institution with a reporting obligation in respect of those interests.

12. From the platform's perspective, it will not be treated as maintaining those accounts where it acts as an adviser or "pure intermediary".

### ***Fund nominees - Distributors in the chain of legal ownership***

13. Distributors that hold legal title to assets on behalf of customers and are part of the legal chain of ownership of interests in CISs are financial institutions. In most cases they will be custodial institutions because they will be holding assets on behalf of others.

14. Normally, the primary business of a fund nominee, fund intermediary or fund platform will be to hold financial assets for the account of others. As such, fund nominees, fund intermediaries and fund platforms should be treated as custodial institutions unless specific factors indicate that their businesses are better characterised as falling within the definition of investment entity.

15. In some cases there may be uncertainty over whether such a distributor meets the condition requiring 20% of the entity's gross income to derive from holding financial assets and from related financial services. This may be the case if, for example, the income derived from acting as nominee arises in another group company, or where income is derived from commission, discounts or other sources where it is not clear whether the gross income test is met.

16. Where this condition is not met, fund nominees, fund intermediaries and fund

platforms will nevertheless still be financial institutions because they would otherwise be within the definition of investment entity. In this case, the financial accounts will be the accounts maintained by the distributor and the distributor will be responsible for ensuring it meets its obligations in respect of those accounts.

17. In the rare case, if the fund nominees, fund intermediaries and fund platforms do not fall within the definition of financial institution, the CIS will be responsible for identifying the ultimate investors (i.e. the account holders) and ensuring compliance with the due diligence and reporting obligations in respect of these accounts. When a fund nominee, fund intermediary or fund platform starts to maintain an account with a CIS, the CIS has to make sure that it is a financial institution before the CIS can be relieved of its due diligence and reporting obligations.

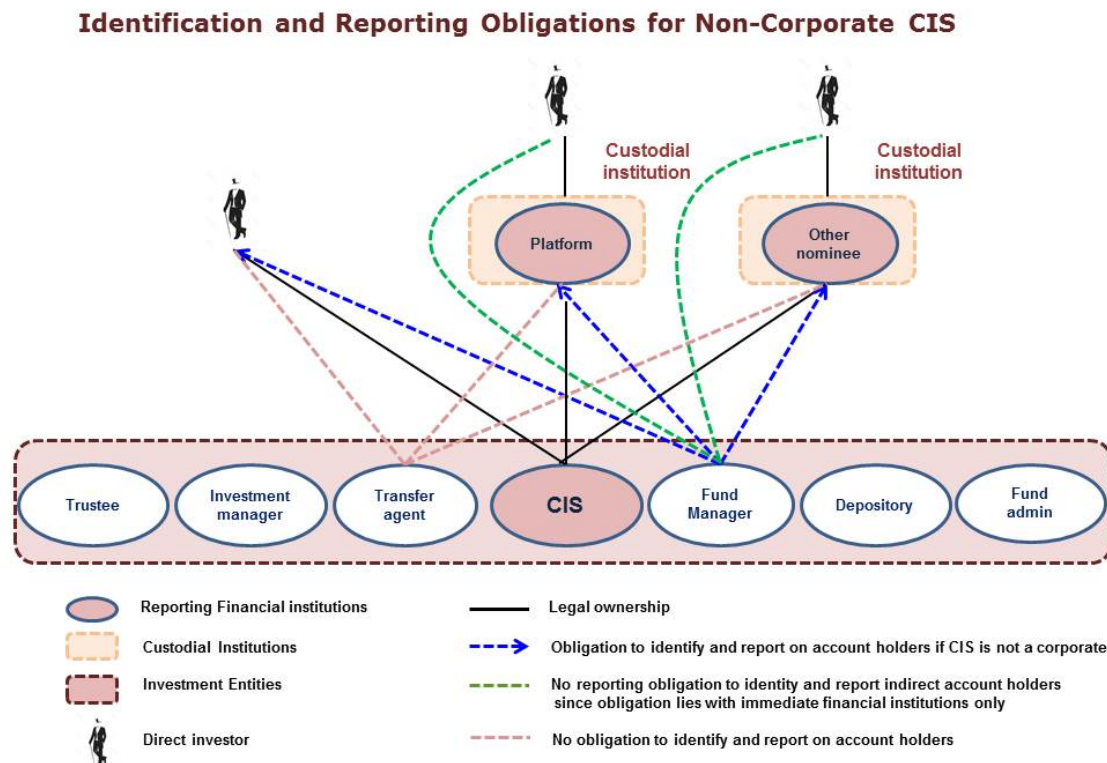
18. For the purpose of aggregating accounts to determine whether any pre-existing custodial accounts are high value accounts, a custodial institution will need to consider all the financial accounts held with them by each customer even though the underlying interests are in different CISs.

#### ***Advisory-only distributors***

19. Distributors that act in an advisory-only capacity and are not in the chain of legal ownership of a CIS will normally not be regarded as a financial institution in respect of any accounts they advise on. Such distributors, which may include some financial advisers, may nevertheless be asked by financial institutions to provide assistance in identifying account holders and obtaining self-certifications. For example, financial advisers will often have the most in-depth knowledge of the investor and direct access to the customer and so will be best placed to obtain self-certifications. However, advisory-only distributors will not normally be regarded as financial institutions and they will only have obligations pursuant to contractual agreements with those financial institutions where they act as a third party service provider in relation to those accounts.

## Identification and reporting on interest in a non-corporate CIS

20. The diagram below illustrates how IRD believes the account identification and reporting obligations under the IRO should work for non-corporate CISs.



21. Depending on how the CIS is structured, various entities may fall within the definition of investment entity. The CIS itself will need to determine which entity carries out the obligations to identify, verify and report on account holders that are reportable, by reference to its own governance structure and contractual arrangements.

22. Authorised CISs in Hong Kong may have a fund manager who is the product provider and has assigned responsibility for fulfilling the legal and regulatory obligations of the CIS, including the anti-money laundering regulatory obligations. Since the provisions in section 50E of the IRO applies to the particular facts of this case, the fund manager will be regarded as the person who acts for the CIS to maintain financial accounts and is responsible for compliance with the due diligence and reporting obligations in relation to the financial accounts of the CIS.

23. A fund manager may use a third party service provider such as a transfer agent to provide fund administration services including maintaining records of investors, account balances and transactions. In these cases, the fund manager might appoint

the third party service provider to fulfil account identification and reporting requirements as they will have the necessary records.

24. The CIS's account due diligence and reporting obligations apply only to its registered account holders. It is required to identify all direct individual account holders pursuant to the due diligence obligations set out in Schedule 17D of the IRO. To the extent that indirect individual accounts are held through a reporting financial institution (e.g. platforms or other nominees), the CIS's obligation is to identify the direct account holder (i.e. the financial institution) only. In turn, the intermediary financial institution will have its own obligation to identify and report on its own account holders.

25. In the diagram above, the fund manager, who acts for the CIS to maintain financial accounts, would need to identify any direct individual account holders (left hand side) and the financial institutions on the share register only. It would be required to report information on any of these that are reportable persons.

26. In turn the custodial institutions that act as distributors (and not the fund manager) would be required to identify and report on their direct account holders. The CIS has no obligation to identify and report on accounts held indirectly through other financial institutions.