



SECURITIES AND FUTURES COMMISSION

證券及期貨事務監察委員會

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Letter to Licensees of Estate Agents Authority

Collective Investment Schemes ("CIS") involving interests in real property

We are pleased to inform you that the Commission has today issued a set of Questions and Answers on CIS involving interests in real property (the "Q&As"). One of the key purposes of the Q&As is to help members of the real estate industry to better understand whether they will be operating, managing or promoting any real estate arrangement (including properties in Hong Kong and overseas) that may be a CIS under the Securities and Futures Ordinance ("SFO"), the offering to the public of which the SFO restricts and which may need an SFC licence to promote and advise investors to invest in such CIS. A copy of the Q&As is enclosed for your information.

We would like to take this opportunity to remind you that it is an offence under the SFO to issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document which is or contains an invitation to the Hong Kong public to acquire an interest in or participate in a CIS, unless the issue has been authorized by the Commission or an exemption under section 103 of the SFO applies. Also, it is an offence under section 114 of the SFO to carry on a business of promoting interests in a CIS without a licence from the Commission.

Please note however that the Q&As should not be regarded as a substitute for obtaining professional legal advice. You should seek professional legal advice if you have any questions about how the law applies to you and you should refrain from taking any action that may constitute a breach of the law.

**Investment Products Division
Securities and Futures Commission**

Enclosure

Collective investment schemes involving interests in real property

These questions and answers (Q&As) provide information about arrangements in respect of interests in real property that may be a collective investment scheme (“CIS”) under the Securities and Futures Ordinance (“SFO”). They are for:

- members of the real estate industry to better understand whether they will be operating, managing or promoting any real estate arrangement that may be a CIS under the SFO, the offering to the public of which the SFO restricts and which may need an SFC licence to promote and advise investors to invest in such CIS; and
- investors to check whether the investment they are invited to invest in may be a CIS.

The information is general and not exhaustive. It does not take into account your particular circumstances. The law in this area is complicated. You should get your own legal advice.

We may update the Q&As from time to time.

	Question	Answer
Regulation of CIS in Hong Kong		
1.	What is a CIS?	<p>CIS is defined broadly in Schedule 1 to the SFO and generally has four relevant elements:</p> <ol style="list-style-type: none"> it must involve arrangements in respect of any property; investors do not have day-to-day control over the management of the property even if they have the right to be consulted or to give directions about the management of the property; the property is managed as a whole by or on behalf of the person operating the arrangements, <u>and/or</u> the contributions of the investors and the profits or income from which payments are made to them are pooled; and

	Question	Answer
		<p>d. the purpose or effect of the arrangements is for the investors to participate in or receive: (i) profits, income or other returns from the acquisition, holding, management or disposal of the property, or (ii) payments or other returns from: the acquisition, holding or disposal of, the exercise of any right in, the redemption of, or the expiry of, any interest in the property.</p>
2.	How is a CIS regulated in Hong Kong?	<p>The SFC regulates the promotion and the offering to the Hong Kong public of interests in a CIS under the SFO.</p> <p>It is an offence under the SFO to issue any marketing material which is or contains an offer to the Hong Kong public to acquire an interest or participate in a CIS unless it has been authorized by the SFC or an exemption under section 103 of the SFO applies.</p> <p>Promoting interests in a CIS may also need an SFC licence if it amounts to a business. To do so without an SFC licence may be an offence under the SFO.</p>
Features of real estate projects that may give rise to a CIS		
3.	Why would the sale of real estate amount to a sale of interests in a CIS?	<p>As stated above, the term CIS is defined broadly in Schedule 1 to the SFO to cover “arrangements” in respect of <u>any “property”</u>.</p> <p>“Property” is also widely defined under the SFO and includes “land” or any estate in land so <u>real estate</u> in Hong Kong or overseas is covered.</p> <p>If arrangements in respect of real property have the elements Q1 explains, they would be a CIS.</p>
4.	What types of real estate and/or real estate projects may be a CIS?	<p>Whether the sale of any type of real estate and/or real estate project amounts to a sale of interests in a CIS depends on the facts including how the arrangements involving real estate are operated and how the property in question is managed under the arrangements.</p> <p>Generally, real estate projects involving interests in hotels/holiday resorts, serviced apartments, student accommodation and shopping malls are more likely to be a CIS</p>

	Question	Answer
		because it is more likely that they need to be managed on behalf of investors. It is also more likely that real estate projects with “buy-to-let” or “buy and leaseback” features could be a CIS as they often involve a centralized letting and management service.
5.	<p>If investors own the individual units in a real estate project where:</p> <p>(i) the units are rented, (ii) the rent is pooled (e.g. the investor receives a proportion of the total income from all the units equal to the fraction their unit accounts for out of all the units), and (iii) a manager makes decisions about how to rent units, to whom, on what terms and whether any unit should be left unlet for a period,</p> <p>are the arrangements likely to amount to a CIS?</p>	<p>Yes, because:</p> <ul style="list-style-type: none"> a. the real estate project involves arrangements in respect of real property, even though investors may have rights to their own units; b. the centralized letting service means that owners of units do not have day-to-day control over the management of the property; c. the property is managed as a whole by the operator of the arrangements; and d. the purpose of the arrangements is for the investors to receive income from the property.
6.	<p>If there is no pooling of contributions and profits or income, would it still be a CIS?</p>	<p>Even if the contributions and profits or income are not pooled, it may still be a CIS. If the property is managed as a whole by or on behalf of the person operating the arrangements and the arrangements have the other elements explained in Q1, the arrangements could still be a CIS.</p>
7.	<p>What does “day-to-day control over the management of the property” mean?</p>	<p>“Day-to-day control” means routine, ordinary, everyday management or operational decisions. The phrase does not just mean the <i>legal</i> ability to decide what is to happen to the property. Rather, the test focuses on whether investors can really make management decisions about the property.</p> <p>Where the contracts appear to give the investors day-to-day control but they do not have that control in practice, the arrangements may still be a CIS even if the investors have the right to be consulted or give directions in respect of such management.</p>

	Question	Answer
8.	If some investors have day-to-day control, but others don't, will arrangements involving interests in real property still be a CIS?	Yes. <u>All</u> investors must have day-to-day control over the management of their properties for a scheme not to be a CIS. Even if one investor does not have day-to-day control the scheme could still be a CIS.
9.	If investors have the right to be consulted or give directions about the management of their units, does it mean that they have day-to-day control?	No. Even if the investors have the right to be consulted or to give directions about the management of their units, that is not enough to stop a scheme from being a CIS. For example, if the operator makes all management decisions using generic mandates (such as a power of attorney) from the investors, even if the investors may have notional control over decision-making, the operator likely has effective day-to-day control over the management of the property, not the investors.
10.	If investors owning different units in the same project appoint the same property agent to lease their units for them, would the property agent be regarded as managing these units as whole and the arrangements be a CIS?	Whether a property is being "managed as a whole" depends on the facts. A property agent would not generally be regarded as managing these units as a whole if the individual investors only engage the property agent to carry out the administrative steps to lease out their units for them according to the terms specified by them under the relevant agency agreements, and the arrangements were that individual investors would direct and make key profit-generating decisions in respect of their own units (e.g. who to lease to, the term of the lease and the amount of rent).
11.	Would a project be regarded as being managed as a whole by a managing agent where: (a) a managing agent manages the project and arranges for leases to be entered into between each investor and a tenant; (b) the investor chooses the tenant and decides the lease terms; (c) the agent runs the project and relationships with tenants, including collecting rent, arranging repairs and insurance, cleaning and security; and (d) the individual investor receives the rent attributable to his/her individual unit?	A project would not generally be regarded as being managed as a whole if the investor made decisions on key matters relevant to an investor's profit (e.g. the identity of the tenant, the terms of the lease and the amount of rent). If so, the project would generally be regarded as being managed on an individual basis as each unit would be managed taking into account each investor's interests. If a managing agent decides things like cleaning and maintenance of common areas, which contribute indirectly to profit, or can get block discounts for all investors for insurance etc., the project would probably still not be "managed as a whole" by the agent.

	Question	Answer
Consequences of promoting or offering interests in a CIS involving real property		
12.	What are the consequences of offering interests in a CIS involving real property to the Hong Kong public?	<p>It is an offence under the SFO to issue marketing material which is or contains an offer to the Hong Kong public to acquire an interest or participate in a CIS involving real property unless it has been authorized by the SFC or an exemption under section 103 of the SFO applies.</p> <p>The maximum penalties for doing this are a fine of \$500,000 and three years' imprisonment.</p> <p>In addition, making a fraudulent or reckless misrepresentation to induce another person to invest in a CIS is also an offence under section 107 of the SFO.</p> <p>The maximum penalties for doing this are a fine of \$1,000,000 and seven years' imprisonment.</p>
13.	What are the consequences of promoting interests in a CIS involving real property?	<p>If you conduct a business of promoting interests in a CIS without an SFC licence, you may commit an offence under section 114 of the SFO.</p> <p>The maximum penalties for doing this are fine of \$5,000,000 and seven years' imprisonment.</p>
14.	Do I need SFC authorisation if only professional investors invest?	<p>It is an offence under the SFO to issue marketing material which is or contains an offer to the Hong Kong public to acquire an interest or participate in a CIS involving real property unless it has been authorized by the SFC or an exemption under section 103 of the SFO applies. One of the exemptions is the issue of marketing material for a CIS that is or intended to be sold only to "professional investors".</p> <p>"Professional investor" is defined in Schedule 1 to the SFO and the Securities and Futures (Professional Investor) Rules. See: http://www.sfc.hk/web/EN/rule-book/laws/securities-and-futures-ordinance.html</p>
15.	What must I do to get SFC authorization?	<p>In considering an application for authorisation of a CIS under the SFO, the SFC may refuse to authorize any CIS where it is not satisfied that the authorization is in the interest of the investing public.</p>

	Question	Answer
		<p>A CIS investing in real property seeking the SFC's authorization is generally required to comply with all the applicable requirements under the Code on Real Estate Investment Trusts including:</p> <ul style="list-style-type: none"> • the CIS must be listed on The Stock Exchange of Hong Kong Limited; • the CIS manager must be SFC licensed or be licensed by the regulator of an overseas regime acceptable to the SFC; • there must be a trustee; and • the assets of the CIS must be segregated and held in trust. <p>See: http://en-rules.sfc.hk/en/display/display.html?rbid=3527&element_id=1235</p>
16.	If I promote interests in a CIS investing in real property to professional investors only does that breach the SFO?	Even if you intend to only sell interests in a CIS investing in real property to professional investors, you may still be carrying on a business which needs an SFC licence. If you don't have an SFC licence, you may commit an offence (section 114 of the SFO). Please see Q13.

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