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Hong Kong Venture Capital and Private Equity Association

香港創業及私募投資協會

The Association for Private Capital in Asia

New Normal

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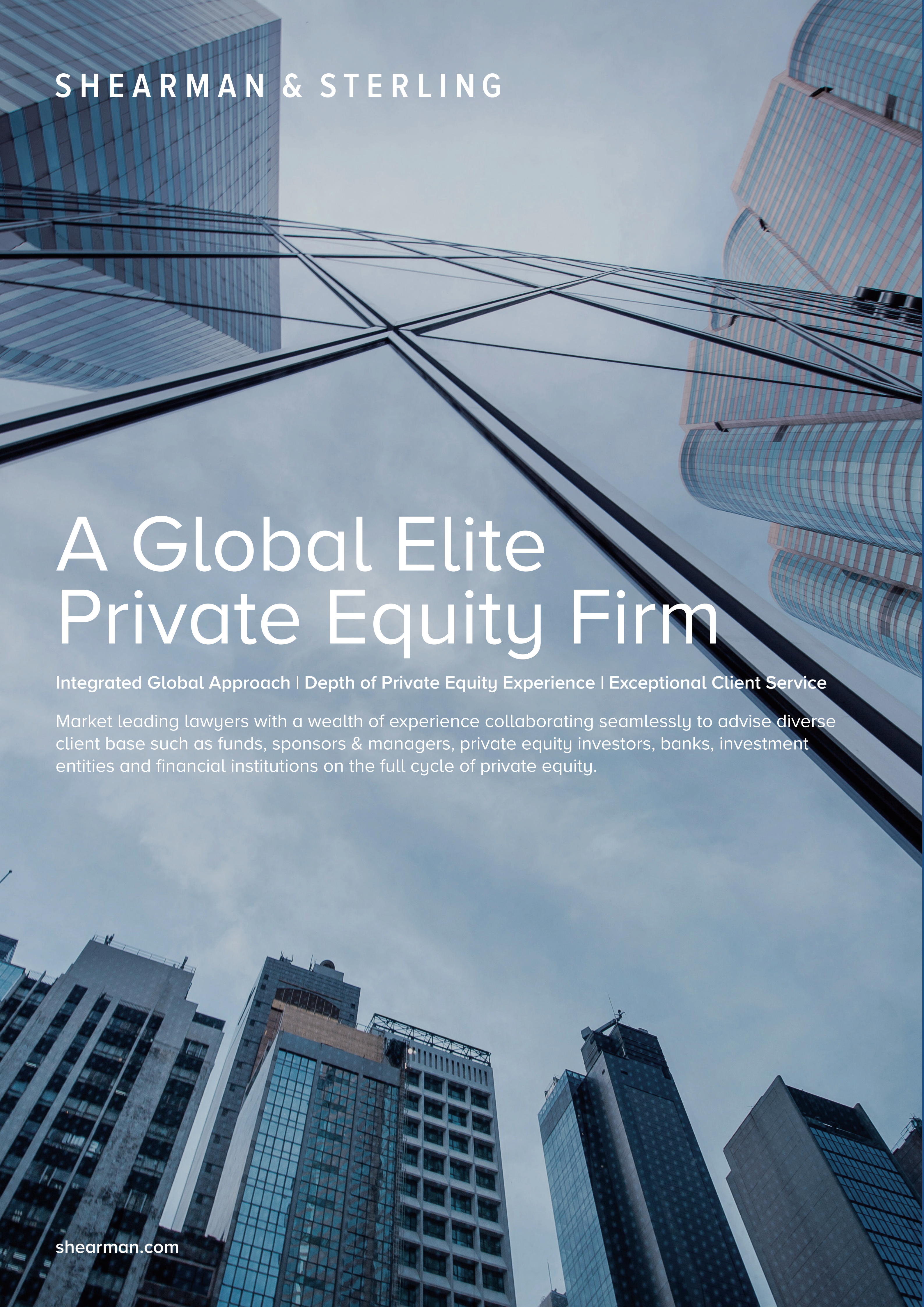

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FOREWORD

COVID-19 has undoubtedly impacted the operating performance of many portfolio companies and logistically affected fundraising of many private equity and venture capital funds. However, it is important not to overlook the innovations and blueprints that are taking shape during the pandemic period. In Hong Kong, its positioning as the international private capital hub in the greater scheme of China's Greater Bay Area strategy is becoming clearer, and this coincides with the progress it has made with Limited Partnership Fund Ordinance, tax rate discount on carried interest, and the Hong Kong Growth Portfolio. We will also try to make sense of the recent phenomenon with the financial innovations in SPACs, and look at how the IPO market addresses the emerging opportunities arising from the biotech and foodtech sectors that appear to be going through important inflection points. Lastly, we want our readers to pay attention to the emerging tax challenges in relation to BEPS 2.0, which can be an impediment to our private capital industry in the near future.

All in all, aside from staying healthy, we hope this issue can make our readers alert of some of the undercurrents that are happening to the Hong Kong private equity industry, amid the inconveniences with the pandemic.

Denis Tse, JP
Chairman, HKVCA Research Committee

HKVCA Mission Statement

The HKVCA's mission is to stimulate a vibrant venture capital and private equity industry in Asia while promoting the role of member firms in value creation, innovation and economic development.

The HKVCA provides a forum for networking and experience sharing for its members, promotes industry professional ethics, international best practices and standards, and represents the views of its members before governmental and other relevant bodies.

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Hong Kong Growth Portfolio: Investing in the City's Future

Samson Wong, Deputy Chief Investment Officer (Private Markets), Hong Kong Monetary Authority

For the betterment of Hong Kong's future

The Future Fund, being an integral part of Hong Kong's fiscal reserves, was established in 2016 as one of the Government's fiscal measures to cope with the foreseeable long-term fiscal challenges arising from the city's ageing population and slower economic growth.

With an initial endowment of approximately HK$220 billion, the Future Fund's capital was strategically placed in longer term investments with a view to securing higher return. Since the Future Fund's establishment, decent return has been earned through placements with the Exchange Fund's Investment Portfolio (investing in the bond and equity markets) and Long-Term Growth Portfolio (investing in private equity and overseas real estate).

To further optimise the use of the Future Fund, the Financial Secretary, Mr Paul Chan, announced in his 2019-20 Budget that he would invite several leaders from the financial services and business sectors to advise him on the Future Fund's investment strategies and portfolios. The objective was to enhance return, while also consolidating Hong Kong's status as a financial, commercial and innovation centre, and raising Hong Kong's productivity and competitiveness in the long run. The group of experienced leaders ("Group") advising the Financial Secretary included Dr Victor Fung, Professor Lawrence Lau, Mr Peter Wong and Mr Norman Chan.

In February 2020, the Government announced that it had accepted the recommendations tendered by the Group to deploy part of the Future Fund to establish a new portfolio, named Hong Kong Growth Portfolio ("HKGP"). The HKGP is expected to make strategic investments in projects with a Hong Kong nexus. The investment mandates will be structured to cover investments in private equity and venture capital.

Governance arrangement and institutional setup

The Group recommended establishing the HKGP outside the Exchange Fund, with an initial allocation of 10% from the Future Fund to be allocated on a gradually funded basis from the Investment Portfolio of the Exchange Fund.

In September 2020, the Government announced that it had established a two-tier committee framework for the HKGP. The framework included a Governance Committee, which would be responsible for setting the basic parameters of the HKGP and providing strategic steer, and an Investment Committee which would decide on the appointment of general partners ("GPs"). The Financial Secretary chairs the Governance Committee which has six non-officials with rich experience in investment. The Investment Committee is chaired by the Secretary for Financial Services and the Treasury, and comprises representatives from relevant government agencies.

Even though the HKGP is no longer placed with the Exchange Fund, the Government has tasked the HKMA with serving as the administrator of the HKGP to provide necessary administrative support, such as sourcing of potentially suitable GPs.

Defining "Hong Kong nexus"

The HKGP is designed to invest in projects with a Hong Kong nexus. For example, a project could be regarded as having a Hong Kong nexus if it would be undertaken by a Hong Kong-based company, or would take place in Hong Kong, or both, or in some other way help enhance the productivity or competitiveness of Hong Kong in the long run. When evaluating whether a project has Hong Kong nexus, the key is that real economic and social benefits could be brought to Hong Kong.

Focusing on the longer term

The investment mandates of the HKGP will be structured to cover investments in private equity and venture capital. As these asset classes are long-term in nature, it would typically take longer time than traditional assets, such as public stocks and bonds, to realise their return. In light of this, it would be more appropriate to appraise the outcome of the HKGP in a longer-term context. Therefore, the Government accepted the Group's recommendations that the return of the HKGP should only be disclosed after a few years of the portfolio's establishment.

Getting started

As mentioned, the HKMA is providing administrative support to the Government on the HKGP initiative. One of the steps taken recently by the HKMA was to conduct a market survey to better understand the profile of private equity firms with interest to become a GP for the HKGP. The market survey ran from 18 December 2020 to 22 January 2021, and we received responses from many local and overseas interested parties. We are very grateful for the participants' generous feedback.

We expect that the appointment of GPs by the HKGP will be made over a period of time in order to build up the portfolio in a gradual manner, and to capture investments of different vintages. We will continue to keep in contact with the private equity and venture capital industries in Hong Kong and overseas as we assist the HKGP's Investment Committee in taking forward this important initiative for Hong Kong.

Samson Wong, Deputy Chief Investment Officer (Private Markets), HKMA

Samson joined the HKMA in 2009 and he is now in charge of all private market investments including private equity and real estate. Prior to joining HKMA, Samson had worked at different investment banks in Hong Kong and US.

Hong Kong Limited Partnership Fund ("HKLPF") Regime: A New Player Enters the Race

Lorna Chen, Asia Regional Managing Partner & Head of Greater China, Shearman & Sterling
Anil Motwani, Senior Associate, Shearman & Sterling
Brian Ham, Associate, Shearman & Sterling

The enactment of the HKLPF regime in August, 2020 has paved the way for Hong Kong to rise as a competitive and market friendly jurisdiction for establishing global private funds. The new regime, from its inception, has been tailored to meet the needs of the modern private funds industry. Based on extensive feedback from a wide range of market players, HKLPF allows contractual latitude for parties to adopt ever-evolving terms, and, at the same time, reduces unnecessary and outdated requirements. Such flexibility is on par with, if not more competitive than, other popular offshore fund jurisdictions, such as the Cayman Islands, which traditionally has been the go-to destination for offshore funds, and Singapore, which is gaining in popularity as an alternative offshore jurisdiction in Asia.

The HKLPF regime has been met with positive early response, which shows that there is a real demand for Hong Kong as a local structuring option in Asia. We expect this trend to further gain momentum with the recent government proposal for 0% profit taxes on eligible carried interest earned in Hong Kong. We think this proposal, if adopted, may tip the cost-benefit analysis for many fund sponsors toward choosing HKLPF for their next generation of private funds.

In this article, we will briefly highlight some of the distinguishing features of HKLPF and summarize how HKLPF holds a competitive edge over other popular and established offshore fund structures, especially those of the Cayman Islands and Singapore.

Documentation

The HKLPF regime grants contractual freedom among the partners, which is overall consistent with other market-friendly jurisdictions like the Cayman Islands, Singapore, Delaware and Luxembourg. For example, the partners are free to decide by contract: (i) the fund's investment scope and strategy, (ii) the partner's respective rights and obligations, (iii) the GP's scope of fiduciary duties, (iv) the remedies for funding default or other breach of contract, (v) the economic arrangements among the partners (e.g., capital contributions, distribution of proceeds and clawback obligations), (vi) the length of the fund term, (vii) the frequency and content of financial reporting, (viii) valuation processes and (ix) fund dissolution procedures. Such broad contractual freedom obviates the need for fund sponsors to undergo major redrafting of existing fund documentation used for funds formed in other jurisdictions.

In contrast to certain other jurisdictions, the HKLPF regime has an additional advantage of not requiring a separate private placement memorandum or other offering document. While we do not anticipate significant changes to market practice as a result of this non-requirement, we do recognize that the lack of this requirement may create additional flexibility regarding the form, content and length of fund marketing materials, and the disclosure of fund information.

When it comes to investor confidentiality, the HKLPF regime takes a more prescriptive approach, which may add to HKLPF's advantage. While the HKLPF regime requires the Hong Kong Registrar of Companies to maintain a public index of HKLPFs, HKLPFs are not required to submit their register of partners for this purpose; register of partners are instead maintained at the registered office of each HKLPF and made accessible for law enforcement officers, but otherwise not accessible to the public. In contrast, for exempted limited partnerships of the Cayman Islands and the limited partnership of Singapore, parties need to opt-in for investor confidentiality by specifically documenting requirements for confidential treatment of investor information.

Tax Treatment

The HKLPF regime, now with the official proposal for 0% profit taxes on eligible carried interest, provides one of the most competitive tax packages in the market. In Hong Kong, tax exemptions for private funds are provided on a jurisdictionally neutral basis under the Unified Tax Exemption Regime in Inland Revenue (Profit Tax Exemption For Funds) (Amendment) Ordinance 2019, such that even a Hong Kong domiciled fund, including an HKLPF, can be exempt from profit taxes as long as it meets the definition of a "fund" and satisfies certain threshold conditions. Such determination is based on self-assessment by the relevant fund and does not involve pre-approval by regulatory authorities. In contrast, in order for a fund to receive tax exemption status in Singapore, the GP is required to receive pre-approval from the local monetary authority. Moreover, funds are required to file tax returns in Singapore.

As for the Cayman Islands, an exempted limited partnership is treated as a tax conduit and therefore is not subject to entity-level taxation. Such fund may, but is not required to, apply for a tax exemption certificate to obtain an undertaking from the tax authorities that no profit will be imposed on the fund for a period up to a maximum of 50 years. While tax treatment at the fund level is more or less comparable to HKLPF, recent legal developments have made it increasingly complicated for fund managers located outside the Cayman Islands to use the Cayman Islands as a means of tax planning. With the introduction of economic substance tests in the Cayman Islands and, in parallel, the ongoing development of transfer pricing regimes in onshore jurisdictions including Hong Kong, fund managers are now required to demonstrate that

management and control are directly exercised from the Cayman Islands if seeking to allocate a portion of carried interest and/or management fees solely to the tax jurisdiction of the Cayman Islands. In this effort, fund managers would be required to prove, amongst other items, physical presence (employees, offices, etc.) in the Cayman Islands that is not nominal. Thus, for fund managers primarily located in Hong Kong, it may no longer be economically advantageous – and may in fact be costly – to structure offshore in the Cayman Islands for tax reasons, especially given the recent proposal for 0% profit taxes on eligible carried interest under the HKLPF regime.

In addition to the advantages in documentation and tax treatment discussed above, we also note that under the HKLPF regime, the general partner or the investment manager is not strictly required to be licensed with the Securities and Futures Commission. Rather, the general partner (in its capacity as an investment manager) or the investment manager is required to be licensed if it carries out certain regulated activities in Hong Kong. This absence of a firm requirement, on its face, may appear as an immediate advantage over Cayman Islands' exempted limited partnership and Singapore's limited partnership/Variable Capital Company that mandate registration with relevant regulatory authorities. However, in practice, this difference may not necessarily translate into non-licensing of general partners or investment managers, given the scope of regulated activities that broadly encompass dealing in, advising on or managing portfolio assets that fall within the definition of "securities". Equally important, the lack of a licensed entity in Hong Kong may also cause the fund structure to lose the otherwise available beneficial tax treatments.

Hong Kong has tremendous potential to rise as a new center for private funds activity in Asia. Hong Kong's proximity to mainland China, together with its position as a financial center in the Guandong-Hong Kong-Macao Greater Bay area, makes it a strategic location for both institutional investors and fund sponsors. With the arrival of the HKLPF regime, Hong Kong has set in place a competitive legal framework that has the power to harness Hong Kong's full economic potential. Furthermore, as a final touch, the Hong Kong government has recently issued a proposal for allowing offshore funds to migrate to Hong Kong under the HKLPF regime. If adopted, existing offshore funds will be able to redomicile to Hong Kong with a relatively simple application/registration process. Given the advantages in documentation and tax treatment, and the potential for an easy and straightforward redomiciliation process, HKLPF may gain further traction in the private funds industry in the coming years. Hong Kong may become a formidable contender in the race to host the next-generation of private funds.

Lorna Chen, Asia Regional Managing Partner and Head of Greater China, Shearman & Sterling

Apart from serving as regional leader, Lorna Chen is also a member of the firm's Executive Group. Lorna founded and leads our asset management and investment funds practice in Asia. Lorna has 20 years' experience in the investment funds and private equity field, advising clients in the structuring, restructuring, formation and operation of alternative investment products. Her recent publications include the chapters on Hong Kong investment funds in the Chambers Global Practice Guide and The Private Equity Review.

Anil Motwani, Senior Associate, Shearman & Sterling

Anil Motwani is a senior associate who represents fund sponsors in all major asset classes and is regularly involved in the design and development of alternative investment products and services, and the structuring and restructuring of private equity funds. He also advises private equity fund sponsors and investors on ongoing operational matters. He is a co-author of chapters on Hong Kong investment funds in the Chambers Global Practice Guide and The Private Equity Review. Anil is also a Chartered Financial Analyst (CFA).

Brian Ham, Associate, Shearman & Sterling

Brian (Seungwon) Ham is an associate in the Asia Investment Funds practice in Hong Kong. He works on transactions involving both fund sponsors and investors in Asia.

Healthcare musings: What would HKEX healthcare look like in 20 years? *

Vanessa Huang, General Partner, BVCF Management

In April 2018, as the Hong Kong Stock Exchange ("HKEX") was launching the new listing pathway for pre-revenue biotech companies (Biotech Chapter/Chapter 18A), I wrote an article for the HKVCA Journal to explain why this commendable effort warranted our most enthusiastic support. The healthcare industry globally was then positively buzzing on how the new rule would have a long-term impact on life sciences R&D. The hope was that Chapter 18A would even make the HKEX the new capital raising destination for global healthcare companies, allowing it to rival the U.S someday. As we approach the third anniversary of Chapter 18A, it is worthwhile to reflect on how healthcare as a sector has evolved on the HKEX and muse on what it can look like in 20 years.

So far, so good

From the launch of Chapter 18A in April 2018 through the end of March 2021, the HKEX has welcomed **63 healthcare listings** (i.e., drug, medtech, and services) on the Main Board, raising HK$196.9 billion (~US$25.2 billion.) Of these 63 listings, **31 are pre-revenue biotech companies** that have listed under Chapter 18A, raising a total of HK$82.1 billion (~US$10.5 billion.) The total HKEX healthcare market cap is now over US$550 billion, almost triple that at the start of 2018. Healthcare currently accounts for approximately 8% of the total HKEX market cap. Given the increased visibility of healthcare, the Hang Seng Index, HKEX's benchmark index, now has four healthcare companies among its 55 constituents – all added after 2018.

As a comparison to Hong Kong's neighbors, HKEX's healthcare market cap is now larger than the combined healthcare market cap listed on all the exchanges across Emerging Asia (Asia ex-Japan, Australia/New Zealand and excluding China domestic listings.) While the exchanges of Korea, India, Taiwan and Singapore have all seen their number of healthcare listings and their total sector market cap increase meaningfully, the HKEX had the highest growth rate by both metrics. A few of these exchanges already had a listing pathway for pre-revenue life sciences companies before the HKEX, which served as reference points for Chapter 18A, but the HKEX now has a clear regional leadership in healthcare listings, especially among China healthcare companies.

What would HKEX healthcare look like in 20 years?

For the past 20 years from 2000 to 2020, the HKEX's total market cap grew at a CAGR of 12.1%. As the HKEX establishes its standing as the listing venue of choice for China and global healthcare companies, if the total HKEX healthcare market cap can grow at the same CAGR of 12.1% for the next 20 years, it will reach over **US$4.2 trillion** – still less than that of the current total U.S. healthcare market cap. As a reference, the CAGR for HKEX healthcare from the beginning of 2008 (the year when healthcare first became active as a sector on the HKEX) to 2020 was ~41%.

* Numbers in the article are rounded for ease of discussion. The HKEX's Chapter 18A listing pathway is open to all R&D focused pre-revenue companies within all subsectors of healthcare (i.e., drug, medtech and services), while in the U.S. "biotech" generally refers to R&D focused high-growth drug companies. Data source: Bloomberg; Nasdaq.

We are currently in a time of great scientific breakthroughs, research on mRNA, immunotherapy, and cell and gene therapy have all been validated with life-saving products. Furthermore, the application of AI and computing power to the process of drug development and disease management will continue to transform the way health and care are delivered to patients, as well as healthy population. This excitement is global and especially meaningful to big population countries such as China. Scientific breakthroughs always lead to active company creation, high capital demand, and attractive investment opportunities. Public listing is an important component to this capital formation process, with the new companies in turn serving as the IPO pipeline for global exchanges.

What type of healthcare companies list on the HKEX?

The HKEX is uniquely positioned in the global financial market given its role as the window to China and the window for China companies to global investors. Approximately 80% of the HKEX's current market cap is from China companies, which also accounted for approximately 90% of the daily trading volume. No other exchange can efficiently replace this unique role at this moment.

This China orientation is also reflected in the healthcare sector, with all but a few of the HKEX-listed healthcare companies being either from China or having China as the end market for its products and services. Especially after the launch of Chapter 18A, the HKEX has created a new avenue that effectively serves the funding needs of China healthcare companies. It is a platform for global investors to capture the attractive investment profile the China healthcare sector presents. This dedicated healthcare capital pool will in turn engender more China and global healthcare companies to list on the HKEX.

Investors and market participants who are new to the healthcare sector on the HKEX may be surprised to learn that at the beginning of 2008 there was only one healthcare company on the HKEX with a market cap larger than US$1 billion and only eight healthcare companies with a market cap larger than US$200 million. The total healthcare market cap was less than US$5 billion then! The HKEX now has around 70 healthcare companies with a market cap over US$1 billion and around 100 healthcare companies with a market cap over US$200 million. There are even five healthcare companies with a market cap over US$30 billion!

How big can healthcare companies be?

Broadly speaking, market cap reflects the underlying sales/net income potential of a company. For healthcare companies, that ultimately means the health needs of individuals. Small is NOT bad in life sciences – science takes time, and most biotech companies started small. Given the substantial value creation by healthcare companies in the long run, the precise IPO valuation becomes less important. Scientific platform and management team are more meaningful for the long-term success of the company (hence investor returns.) For example, the current top ten U.S. listed biotech companies have a combined market cap of approximately US$500 billion (almost equivalent to

Table 1: Top ten U.S. listed biotech companies by market cap

(US$mm)	IPO date	Market cap at IPO	Amount raised	Current market cap (12/31/20)
Amgen Inc.	Jun-83	190	36	133,852
Gilead Sciences Inc.	Jan-92	216	86	73,031
Vertex Pharmaceuticals Inc.	Jul-91	156	27	61,457
Regeneron Pharmaceuticals Inc.	Apr-91	306	99	51,551
Moderna Inc.	Dec-18	7,566	604	41,340
Biogen Inc.	Mar-83	432	58	37,679
Alexion Pharmaceuticals Inc.	Feb-96	58	21	34,173
Seagen Inc.	Mar-01	201	49	31,349
BioNTech SE	Oct-19	3,402	158	19,629
Incyte Corp.	Nov-93	46	17	19,048
		12,572	1,155	503,110

Source: Dealogic. Market cap at IPO for Vertex and Regeneron based on earliest available share outstanding times IPO price the total HKEX healthcare market cap.) However, their combined market cap at IPO was only approximately US$12.6 billion, and in fact if we exclude the two most recent listings, BioNTech and Moderna, the other eight had a combined market cap at IPO of less than US$2 billion.

The largest healthcare company by market cap is Johnson & Johnson ("J&J"), at approximately US$425 billion. As a global company, about half of J&J's 2020 sales were from outside of the U.S., and only one-third of its employees are based in North America. The market cap therefore reflected consumption of J&J's products in other countries even though the company is listed in the U.S. – many U.S. listed healthcare companies such as Pfizer and Medtronic have similar global profile. Many non-U.S. healthcare companies such as BioNTech (Germany) also list on the U.S. exchanges.

By contrast, most of the China healthcare companies, whether they are listed on the HKEX or as China A shares, are still China focused with limited overseas sales. One of the most global China healthcare companies is Mindray, a medical device company listed on the Shenzhen Stock Exchange with market cap of approximately US$85 billion. Around 40% of Mindray's 2019 sales were from outside of China. However, Mindray's products still only accounted for less than 1% of the total market share in Asia and Latin America. As China's healthcare companies expand to become global companies similar to their counterparts in other industry sectors, their sales and market cap will increase accordingly.

How many listed healthcare companies should there be?

As a reference, the U.S. has the largest healthcare market with annual healthcare spend representing close to 20% of GDP. There are around 1,000 listed healthcare companies in the U.S. with a total market cap of approximately US$6.7 trillion, representing approximately 11% of the U.S. market cap.

The total China healthcare market cap is approximately US$1.5 trillion (~US$550 billion of HKEX listings plus ~US$1 trillion of China domestic listings). There are around 170 healthcare companies listed on the HKEX, all but a few are from China. While market cap is not the perfect reflection of sector value and part of the U.S. healthcare market cap represents global consumption, it is not hard to imagine we are still early in the growth process of China's healthcare sector given China has over four times the U.S.'s population.

The first large scale healthcare listing on the HKEX was Sinopharm's US$1.1 billion offering in September 2009. As one of the investment banks working on the IPO, I remember explaining to our internal committee why we need to do such a "small" deal in an "obscure" sector no one looked at. It was a time of properties and financial institution IPOs then. Now almost every investment bank, law, audit, and consulting firm have healthcare focused teams. Institutional investors, along with sell-side research, have also set up dedicated Asia healthcare teams with relevant science background. Even Hong Kong retail investors are excited about healthcare, as seen by the significant retail tranche oversubscription for many recent healthcare IPOs. This ecosystem has taken 10+ years since the first healthcare IPO to mature, but this is the engine that will support the continuous listing of healthcare companies on the HKEX.

In conclusion

While we look forward to the exciting years ahead for HKEX healthcare, we should always remember the human aspects of healthcare investments – as healthcare companies transform from a few scientists to future giants, they will hire thousands of employees and create wealth for both their employees and investors, who will then go on to fund additional healthcare companies. The products they develop will save thousands of lives. We should also remember that if there is no capital available for these small healthcare companies, many drugs and technologies would never make it to market, many jobs would never be created, and many lives would be left unsaved. We should always support healthcare!

Vanessa Huang, General Partner, BVCF Management

Ms. Vanessa Huang is co-Chair of HKVCA Healthcare Committee. Ms. Huang is currently a General Partner at BVCF Management. Prior to joining BVCF, she was Head of Emerging Asia Healthcare Investment Banking at J.P. Morgan. Ms. Huang gained biotech industry experience at Amgen. Ms. Huang is a member of the HKEX Biotech Advisory Panel and an independent non-executive director of Alibaba Health Information Technology Limited (Stock code: 00241).

FoodTech Investment and Its Latest Trend

Eric Ng, CEO, Happiness Capital

Startups Help Tackle The Global Food Challenges

The United Nations estimate the world will have an additional 2 billion people by 2050. Assuming the continuation of our current food consumption pattern, it could lead to a doubling of demand for food production. We can address at least part of the problem by growing more crops and livestock, but the consequences of severe climate change and other natural disasters such as pandemic, swine flu and locust plague could potentially jeopardize the supply of sufficient food for all the people in the world.

On the other hand, food production must become more sustainable. The global food system accounts for roughly 30 percent of the global greenhouse gas emissions. Roughly 70 percent of the freshwater from the world's rivers, lakes and groundwater is used up to grow crops or raise animals. For instance, each serving of beef consumes more than 7,000 glasses of water. Most of the land on Earth that is suitable for agriculture has already been converted to fields or pasture.

Food sustainability is about culture, education, health, equity and respect for the planet we live on. Sustainable food isn't only about the food itself. It's a combination of factors including how the food is produced, how it's distributed, how it's packaged and how it's consumed. Sustainable agriculture supports organic and low carbon food production. It also avoids the use of artificial fertilisers and pesticides as well as genetically modified organisms. Sustainable food aims to avoid damaging or wasting natural resources. It also minimizes its contribution to climate change throughout the whole production process. Developing a global food system that both achieves food security and reduces its environmental impact is one of the foremost challenges of our time.

Furthermore, consumers are becoming more informed about the food they eat, leading to more thoughtful and healthier eating decisions. Reducing meat consumption in favour of fresh produce is increasing in popularity for both health and environmental reasons. Overconsumption of certain types of meat has been linked to several health issues, including cardiovascular disease and colorectal cancer.

Most of the recent FoodTech companies share the same mission of tackling these global food challenges in different ways. The main innovations are around:

- Alternative protein which includes cultivated meat, plant-based meat and dairy, fermented protein, and novel ingredients;
- Sustainable Food Production;
- Food Safety, Quality and Traceability;
- Food Waste and Packaging; and
- KitchenTech and Robotics.

FoodTech companies raised over US$18 billions across more than 700 deals in 2020, especially alternative protein companies. The global meat and dairy market combined is over US$2 trillions. These innovative companies are rapidly grabbing market share from traditional meat and dairy incumbents. Beyond Meat's high-performing IPO signalled to investors that there is opportunity in the alternative protein market. In addition to IPO exits, acquisitions are expected as the largest players look to gain market share and as incumbents seek to acquire innovation. Danone, Unilever, Nestle, etc. are very active in investing and acquiring startups in the food and beverage sectors.

In this article, we will focus on Alternative Protein and Sustainable Food Production as these startups have attracted most of the investments in recent years.

Plant-Based Meat & Dairy

Food science innovations have allowed plant-based producers to create more realistic alternatives to meat and dairy products. The earlier successful plant-based meat products such as those from Beyond Meat and Impossible Foods deliver healthy and environment friendly options but still have expectation gaps in taste and texture which are important during consumers' food selection. The latest innovations include 3D Printing of plant-based Whole-Muscle Cuts, i.e. plant-based steak, from Redefine Meat in Israel, of which Happiness Capital was the co-lead investor of their recent US$29M Series A round.

Redefine Meat looks like a steak, tastes like a steak & sizzles like a steak (see picture below). Redefine Meat's patented industrial-scale digital manufacturing technology achieves the unbelievable: delivering high-quality, sustainable plant-based meat products with a taste and mouthfeel indistinguishable from traditional animal meat. Even the cooking experience mimics the experience of cooking conventional meat such as smoke, smell, color change, cooking time, cooking on flame or pan, and grill marks. One of the key challenges that plant-based meat and cultivated meat have not overcome is fat marbling. 3D Printing of meat achieves fat marbling with ease as you may even design your own degree and pattern of fat marbling. The 3D Printer uses 3 "ink" cartridges for printing muscle, fat, and blood to build your perfect piece of steak. The "ink" cartridges are designed for easy replenishment.

Plant-based dairy products such as Oatly and Ripple Foods have been gaining market share every year while the sales of dairy products worldwide has been dropping significantly (in billions of US$) at the same time. In recent years, innovations on fermented protein offer new ways to produce dairy without cows and a new kind of food that contains both protein and fiber.

Fermented Protein

Fermentation technologies use microbes like microalgae and mycoprotein to produce protein such as milk protein. Microbes currently used by FoodTech startups include yeast, fungi (e.g. mushroom, mycelium), and algae. Fermented protein does not contain lactose, cholesterol, hormones, and antibiotics that one may find in cow's milk.

Pioneers like Perfect Day and Clara Foods have been making in-roads to the market with ice-cream and egg-white. Newcomers include Mushlabs in Germany that produces meat replacement from mycelium with upcycling of sidestreams without soil or sunlight. A 100 gram serving of Mushlabs meat already contains the

protein and fiber for an individual's daily needs. Legendairy Foods in Germany produces delicious cheese without cows. Better Dairy in the United Kingdom uses machine learning and synthetic biology to produce casein without cows for food manufacturers. All of these newcomers are invested by Happiness Capital as part of a drive towards sustainable food production and healthy food options.

Cultivated Meat

On December 1, 2020, Eat Just, an alternative protein company, became the first to receive regulatory approval to commercialize cultivated protein. Eat Just's lab-grown chicken meat was approved by the Singapore Food Agency (SFA) to sell as chicken nuggets. Hundreds of restaurants in Singapore have started serving Eat Just chicken nuggets since then. This has further fuelled the investments and competition in cultivated meat.

Cultivated or cultured meat is made using tissue-culture technology (the process by which animal cells are regenerated from a single cell) to create muscle tissue that mimics animal muscles in bioreactors without the slaughter of an animal. Currently cultivated meat products include beef, chicken, pork, fish, prawn, and fish maw. The well-known players are Memphis Meat, Meatable, Mosa Meat, Aleph Farms, BlueNalu, and Avant. However there are hundreds of new players entering the competition worldwide.

Challenges like regulatory approval, cost/price, scalability, genetic-engineering in the production process, diseases caused by real meat/fat, and consumer confidence will still need to be overcome before mass market adoption.

Novel Ingredients

Insect protein is one of the key novel ingredients. Crickets, grasshoppers, mealworms, and black soldier flies are leading the pack of favoured protein alternatives for large-scale commercialization. Most insect protein companies do not currently target human food as their end products since consumer acceptance is still low. Fish and animal feeds are the most common end products made from insect protein today. YNSECT is an insect protein company in France that produces fish and animal feeds using mealworms. The powder produced becomes part of fish feeds while the oil produced becomes coating on pet food. This represents a zero-waste sustainable food production process. The salmon and seabass that are fed with YNSECT products can grow 30% faster and much healthier with a very low mortality rate. Hence no anti-biotics or other chemicals are needed to feed the fish to keep them healthy, which is also good for human health in the long run.

Some innovative novel ingredient startups even go beyond the conventional food production ecosystem to produce food by consuming CO2 and without any form of agriculture. Solar Foods in Finland produces protein using air (CO2 in particular), electricity, water and microorganisms without soil and sunlight. Novonutrients in the US connects their food production facility directly to the CO2 emission outlet of a factory to produce protein in a similar way by sucking-in the factory's CO2 emission. These two companies are truly carbon-negative.

Happiness Capital also invested in YNSECT, Solar Foods and Novonutrients to help the world in achieving carbon-negative and securing our future food supply without any conventional agriculture ecosystem.

What's Next? Food for Living in Space?

Severe climate change may be irreversible. The next pandemic may be inevitable. Swine flu and locust plague may come again. We should invest in making our food system more sustainable to secure quality food supply for our future generations. On the positive side, living in space for ordinary people may also soon become a reality. Eating well with tasty and nutritional food in space is important for travelling in space or even for adapting a new life in space. The next race may be on food for living in space.

Eric Ng, CEO, Happiness Capital

Eric leads Happiness Capital, the "do well and do good" global venture capital arm of LKK Health Products Group (a Lee Kum Kee company) with the mission to create global impacts and make the world a happier place. Happiness Capital's current investment portfolio covers US, Europe, Israel and China. The major impact goals focus on food, health, trust, climate change and reduced inequalities.

Subscription Line and Beyond

Emma Wang, Managing Director - Head of Private Equity, East West Bank

Background

A subscription line (aka capital call line) was a relatively new concept 15 years ago, when only a few banks offered this credit product as a customized solution to a closed-end investment fund on a selective basis. It has become popular over time, spreading from the U.S. to Europe and Asia, and is commonly referred to now as Fund Finance. The extensive global network around Fund Finance includes lenders, lawyers, fund administrators and other service providers.

The main purpose of a fund subscription line is to bridge the timing difference between a deal closing, the timing of which could be hard to predict, and the proceeds from a capital call that is not available immediately as it usually takes about two weeks before being received from the LPs. The ability to have an immediate source of funding with a modest cost is attractive to GPs. This short-term solution could help ease the administrative burden in a dynamic environment, ensure liquidity to act quickly on a competitive deal, and smooth the LP's expectation on the frequency of capital calls.

Key Elements of Structure

A traditional subscription line is a revolving line of credit that can be drawn, repaid, and redrawn when there is a need. The tenor of the line may vary, but usually lasts one year and is renewable each year. To demonstrate the revolving feature as short-term borrowing, it usually requires a clean-up during the term of the facility.

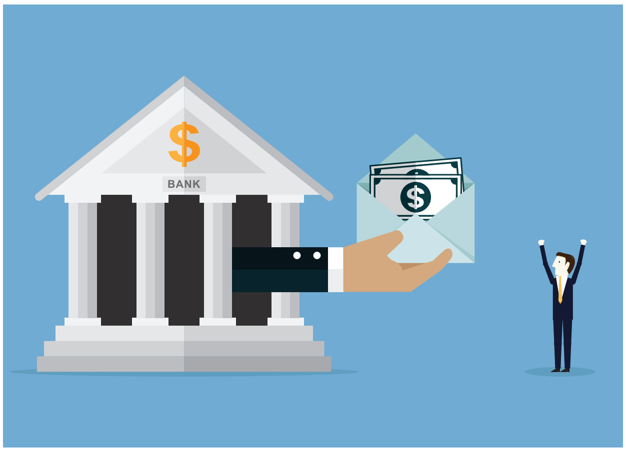
The line is secured against a pledge of the unfunded capital commitments from the LPs; it is in the form of a collateral assignment of the right to call and receive capital contributions from the LPs. If the GP fails to repay the loan, the bank can call upon the LPs directly and collect the proceeds from the capital call to fulfill the loan repayment.

The loan amount is generally set at the average investment size, or 15-30% of the capital commitments, while the average loan outstanding is about 20-30% of the loan amount given the nature of short-term bridge financing. The actual drawdown is also controlled by a borrowing base with an advance rate against the unfunded capital commitments from the LPs. The advance rate is mainly determined by several factors of the LPs, including the level of available background information, their investment experience in this asset class, their willingness to support the credit line, the level of granularity of the LP commitments, and the lender's experience in dealing with such LPs.

Other controls may include a concentration limit of the LP commitment, a threshold on LP default and transfers, and a requirement of bank accounts to monitor capital calls and to perfect the security.

Due Diligence and Execution

A successful closing of a subscription line largely depends on legal due diligence and document execution. The process usually starts with a short list of items: organizational chart, private placement memorandum (PPM), and limited partnership agreement (LPA). The LPA lays out the relationships and rights of the GP, the LPs and the fund. It also includes provisions for incurring debt, with limitations on the loan amount, restrictions on the borrowing period and the terms of pledging of the LP commitments. Some lenders might involve a lawyer to review the list



before it can issue a term sheet, while the others are able to check all relevant sections and will not engage legal services before the credit approval is obtained.

In Asia, the LPs seem to have great bargaining power, and many LPs sign side letters in addition to the constitutional documents. Some side letters may be extensive and include provisions beyond common terms. While GPs are reluctant to disclose these side letters, the lenders need to review them. Additionally, lenders require a market-standard legal opinion for a Cayman registered fund at closing. It serves as an extra layer of comfort to the lender for a loan to an offshore borrower. Under Cayman regulations, it is also important to deliver the notice of the collateral assignment of the capital call rights to the LPs in order to perfect the pledge against the LP commitments. They must present evidence of such notice having been received at closing.

For many years, subscription lines have been considered a safe product with few verifiable payment defaults, even during the COVID -19 pandemic. There are only two significant loan defaults to date: The Abraaj Group in 2018 and JES Global Capital in 2021. The global community of fund finance has had many discussions over this perceived risk. A great resource for a thorough analysis of all possible legal risks can be found in Global Legal Insights – Fund Finance.

New Demands

While the majority of fund financing in the Asia market has been traditional subscription lines (which are more or less commoditized), the market has also seen an increasing demand in more structured and bespoke facilities. These facilities are heavily structured and only offered by a limited number of lenders in the market who have the appropriate internal resource to offer these customized solutions.

Hybrid facility: It is designed to support funds that are just beyond investment period, but are still in need of some capital to make follow-on investments. The borrowing base involves a combination of a recourse to the remaining uncalled capital from the LPs and a recourse to the underlying portfolio assets.

NAV-based facility: This offering is designed for funds during the later stages of their lifecycle, when there is no uncalled LP commitments available in the borrowing base. The facility will be secured against the value of the portfolio, and recourse to the cashflows and distributions from the fund's underlying investments.

Management Company / GP facility: When a GP manages multiple funds, the cash requirement can be quite significant. This facility can be used for multiple purposes: to finance working capital of the management company, and to support GP / employee's capital contributions in the funds.

Other facilities to SPVs: It differs from case to case, and is solely customized to meet each unique situation.

Emma Wang, Managing Director, East West Bank

Emma's entire banking career has been in fund finance. With 15 years in banking private equity firms in both the US and Asia, Emma leads the East West Bank's fund finance practice in Asia, specializing in providing customized and creative transactions to PE/VC firms. East West Bank (NASDAQ: EWBC) is the only bank in the U.S. that focuses exclusively on the United States and Greater China markets.

Making Sense of SPACs

Denis Tse, JP, CEO, ACE Equity Partners International

The first quarter of 2021 saw US SPAC IPOs raising more funds than conventional IPOs in the same period and almost eclipsing the amount raised from SPAC IPOs in the whole year of 2020, which in turn raised more SPAC IPO proceeds than all previous years combined. Then market sentiment toward SPACs took a drastic turn. As the market is going through a phase of self-regulation, it makes sense to speak from the perspectives of both a sponsor and a seller and put some sanity on the topic of SPAC investing in light of such pendulum mood swings.

To company boards

SPAC merger is a form of PIPE financing that has its distinct merits that appeal to certain capital-intensive companies. The liquidity aspect of the SPAC securities makes a deal more appealing for investors, allowing a company to raise a significant amount of equity financing more easily than in a private round. The ability to bilaterally negotiate special terms in a SPAC merger transaction also allows sophisticated buyers and the issuer to bridge the differences more dextrously to close the funding round than a conventional IPO would afford. These best-of-both-worlds features, now that they have been brought to the attention of investors and private company boards, make the case that SPACs would be here to stay.

Companies and investors must not ignore the fact that after the business combination is complete, the combined company will be treated no differently from other public companies, and will be subject to scrutiny by the public market quarter after quarter. While a SPAC-merging company circumvents the gatekeeping of IPO underwriters and can enjoy making forward-looking statements more freely, its shareholders must not forget that they remain the largest shareholder block post-merger and will be subject to customary lock-up, at least substantially, for as much as a year. Some companies having gone through de-SPAC already disappoints greatly after their first public quarterly report, and their market cap falls with their market expectation credibility. For companies that are not ready to be public in the first place, a SPAC merger benefits neither their original shareholders nor the public.

To private equity investors

The payoff of SPAC sponsorship is no doubt lucrative relative to the amount of risk capital required. SPAC IPO also looks easy to launch because public subscribers are attracted to the right to recoup their investment (plus some interest) by redeeming their shares at the merger general meeting, and still get to keep the upside of the warrants that come with the IPO unit.
To put it in perspective, according to an Asian early-stage venture investor, the enhancement from SPAC sponsorship justifies his entry into late-stage investing[1]. The lucrativeness of SPAC sponsorship can result in perverse objective in that the payoff for the SPAC sponsor is much higher to consummate a merger with a bad company than to liquidate the SPAC without a merger.

With low barriers to entry, private equity managers must not be naïve about how quickly SPAC formation as an investment strategy can become a crowded trade. The market's appetite for cash box allocation also has its limit and shifts over time, and SPAC public shareholders in the

[1] Questions raised about LP-GP alignment as PE firms join SPAC craze", AVCJ, March 2 2021

end still hold the card of redemption. If they see better opportunities elsewhere than the merger deal the SPAC presents, the resulting level of redemption can break the deal. Moreover, doing a bad SPAC deal not only affects the private equity sponsor's ability to return to the market with a successor SPAC; it may also have a lasting impact on the manager's core private equity fundraising franchise.

The bottom line: it still boils down to the quality of the de-SPAC. If the private equity sponsor can demonstrate that it can speedily execute a proprietary attractive merger in a competitive environment, it deserves to be rewarded as the market flocks to quality.

Nonetheless, with the vast amount of capital currently locked up in SPAC trusts facing only increasing liquidation risks, private equity managers may have more fun utilizing their SPAC transaction skill as a seller than as a buyer.

To asset owners

SPAC formation is a form of enhanced PIPE investing. For a private equity fund that is allowed to engage in PIPE investing up to a certain limit, sponsoring a SPAC or even multiple SPACs with a private equity fund is not in and of itself abhorrent as far as the private equity fund's permitted activities are concerned. What the fund manager and its investors need to reconcile is whether SPAC sponsoring is in line with the fund's general partner time dedication, contribution and staff co-investment policies, framework that should have been negotiated in the fund's limited partnership agreement.

From a portfolio allocation standpoint, asset owners should realize that SPACs are unlikely to fall back into obscurity. To the extent that SPAC investing is considered attractive, an asset owner should decide whether it would concur that it is a form of PIPE investing and therefore should be grouped as a private equity investment allocation; or it would recalibrate its minimum market capitalization requirement to accommodate SPAC investing in its public equity investment program, in much the same way as an IPO cornerstone investment.

In sum, SPAC as a financial innovation is neutral. Private equity managers can see sponsored SPAC as a platform portfolio company investment, and external SPACs as a strategic option for investment liquidity and follow-on fundraising. Simply looking at SPAC merger with stigma clouds a company board's prudent judgment. Limited partners should also embrace SPACs as an emerging asset class variant, and may even sponsor SPACs themselves, as a number of family offices already do.

Denis Tse, JP, CEO, ACE Equity Partners International

Denis Tse, JP is CEO – International with ACE Equity Partners, an Asian cross-border technology private equity firm with over US$1 billion of assets under management. Denis has more than 20 years of investing experience in private equity and venture capital, including six years as the Head of Asia – Private Investments with Lockheed Martin Investment Management Company, where he was named "40 under 40" by Chief Investment Officer. Denis was also the first Kauffman Fellow from an Asian venture capital firm.

大湾区私募股权投资发展的一些思考

Strategic Thoughts on the Convergence of the Development of the Private Equity Industry in the Greater Bay Area

Shuang Chen, JP, Founding & Managing Partner, APlus Partner

Ever since the strategic development of the Greater Bay Area has been elevated to the national level by the Chinese government, converged development becomes the central theme for the planning of the Greater Bay Area. Owing to the differences in level of development, political systems, financial regimes and cultural backgrounds between Guangdong, Hong Kong and Macao, converged development is a long process. The imminent step should therefore focus on freer intraregional travel, customs and capital flows.

Trading of goods is essentially free of obstacles at this moment, as free flow of cross-border capital is achievable by means of cross-border settlement, letter of credit and other forms of payment. However, with regards to the capital accounts, the capital flow is not fully accommodated.

The existing channels for capital flow of capital accounts include:

(1) Step-by-step approval of exchange settlement in the form of Overseas Direct Investment (ODI) and Foreign Direct Investment (FDI);
(2) Products offered by securities exchanges through Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect and Bond Connect programs;
(3) Cross-border, through managed quotas of Qualified Foreign Institutional Investor (QFII)

粤港澳大湾区发展已经上升为国家战略，融合发展是大湾区的核心内容。由于三地的发展水平不同，政治体制不同，金融体系不同，文化背景不同，融合必然是一个漫长的过程，打通人流，物流，资金流是现阶段的核心。

关于资金流打通的问题，目前贸易项下已经没有障碍，跨境结算，信用证及其他支付方式等可以实现资金的跨境自由流动。至于资本项下的资金流动，目前主要有以下渠道：

(1) 通过 ODI 和 FDI 方式，层层审批，以结售汇方式实现跨境流动；
(2) 通过交易所推出的沪港通，深港通以及债券通产品进行跨境流动；
(3) QFII 和 QDII 途径，通过额度管理的方式，实现跨境的投资；
(4) 此外还有小额的个人汇兑汇出等。

上述途径显然无法满足跨境资金流动的现实需要，对人民币的国际化显然也不利。

逐步打通资本项下资金跨境流动的障碍，粤港澳大湾区最有可能为率先试点，率先突破。央行等四部委 2020 年底出台了《关于金融支持粤港澳大湾区建设的意见》，其中对私募股权投资方面，提出了允许港澳机构投资者通过 QFLP 参与投资粤港澳大湾区内地私募股权投资基金和创业投资企业。同时提出了有序推进合格境内有限合伙人（QDLP） and Qualified Domestic Institutional Investor (QDII) programs; and, of course,

(4) Personal wire transfers in small amounts.

These existing channels are far from meeting the actual needs of free cross-border capital flows, and such limitations are a impediment to the internationalization of the Renminbi.

To gradually remove the obstacles to capital account flows, the Greater Bay Area is the most likely location to launch pilot programs. In 2020, the People's Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange jointly released “The Opinions for Financial Support for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area” (《关于金融支持粤港澳大湾区建设的意见》, or the “Opinions”). With respect to private equity investing, institutional investors in Hong Kong and Macao should be permitted to invest in onshore private equity funds and venture capital investment enterprises established in the Greater Bay Area through the Qualified Foreign Limited Partner program. New measures, including the orderly launching of Qualified Domestic Limited Partner (QDLP) and Qualified Domestic Investment Enterprise (QDIE) pilots should be undertaken. In addition, support for onshore private equity funds to invest outbound; and for non-investment enterprises to engage in private equity investment should be allowed.

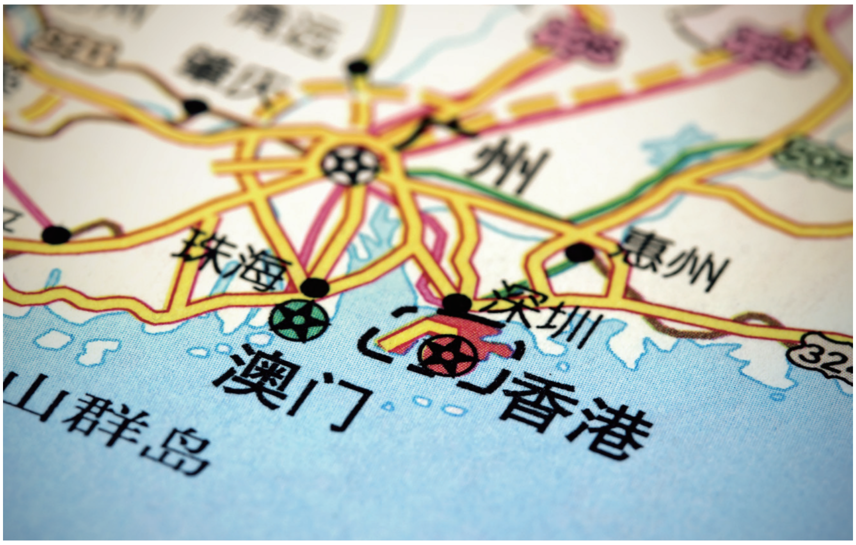
These new policies proposed by the Opinions would likely bring new opportunities to the development of private equity in the Greater Bay Area. They can be effective catalysts for the convergence of development in equity investment in the Greater Bay Area, in the following ways:

1. The Limited Partnership Fund Ordinance that has commenced operation in Hong Kong since 31 August 2020 puts an end to the long-time practice of using offshore structures to circumvent taxes in Hong Kong by putting fund establishment and fund management under one jurisdiction. Furthermore, the Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Bill 2021 has been gazetted and is expected to be passed into law soon, enabling the Hong Kong tax regime to provide taxation clarity to limited

和合格境内投资企业（QDIE）试点，也提出了支持内地私募股权投资基金境外投资，同时《意见》也提出了非投资类企业开展股权投资试点等一系列措施。

这些规定无疑为大湾区私募股权的发展带来机会，同时我也观察到大湾区股权投资融合出现的一些可喜的变化，包括以下方面：

1. 香港《有限合伙基金条例》自 2020 年 8 月 31 日起已正式实施，条例打破了长期以来香港用离岸架构避免征税的复杂状况，实现了基金结构和管理地点的一致性。与此同时《2021 年税务（修订）（附带权益的税务宽减）条例草案》正式刊宪，并有望在近期正式通过，从而解决长期以来 GP 和 LP 通过复杂的结构改变香港税收的问题。香港对私募股权的法律和税制的改革，将极大的促进全球投资者向香港聚集，香港将成为全球私募股权机构的集中地。
2. 中国内地资管新规出台后，银行资管资金投资私募股权基金受到很大的限制，从大湾区的私募股权基金的募集中可以清楚的看到这一点。大湾区中国内地的募资在 2017 年达到高峰后，开始逐年下降。这种状况可以通过境外资金的进入加于弥补。由于市场对通货膨胀的担忧和全球配置人民币资产的需求，透过香港私募基金配置中国资产成为常态，既有二级市场的配售，也有通过 S 基金方式，寻找合适的人民币计价资产投资中国。当然我们希望有关 QFLP、QDLF 和 QDIE 相关政策可以尽快出台，使透过港澳配置内地资产的障碍得以消除。
3. 粤港澳三地的分工协作开始逐步清晰，为私募股权投资创造更多便利。澳门是相对资金充足的地方，可以通过对私募股权基金的投入配置到大湾区的优质资产中；香港具有吸引全球金融机构的能力，具有澳门和大湾区内地地区所不具备的优势，成为大湾区金融的核心区；而大湾区的内地包括深圳和广州，已经成为了科技落地的核心区域，三地的分工协作，可以为不同阶段，不同领域的投资创造条件。
4. 十四五规划纲要中，第一次将香港定义为创新科技中心，这点大家非常关注，甚至有些怀疑。关于这一点，我在 4 月 12 日信报的文章《中国高端制造业的转型升级和香港的机遇》一文中做了阐述。近十多年来，香港利用优势的大学



partners and general partners with respect to funds operating in Hong Kong. The legal and tax reforms Hong Kong has taken toward private equity will attract investors around the world to Hong Kong, making Hong Kong the hub of global private equity institutions.

2. Ever since the new government policies with respect to onshore asset management have come into effect, banks' asset management capital has faced significant restrictions on investing in private equity funds. This is reflected in the private equity fundraising in the Greater Bay Area, where it has been dropping substantially every year since it peaked in 2017. Offshore capital investment can increase private equity fundraising significantly. Due to concerns about global inflation and demand for RMB assets by global asset allocators, investors can build exposure to Chinese assets via private equity funds operating in Hong Kong either by means of PIPEs in the onshore public equity market, or by acquiring RMB-denominated direct or fund assets via secondary private equity strategies. It is hoped that policies regarding QFLP, QDLP and QDIE will come into full effect soon to remove the hurdles of onshore asset allocation through Hong Kong and Macao.
3. Coordination and cooperation of roles between Guangdong, Hong Kong and Macau has become increasingly clear, and this facilitates private equity investing. Macao is relatively flushed with capital and is capable to invest more into high-quality assets in the Greater Bay Area through private equity fund allocation.

资源，吸收了来自内地的大量优秀学生，研究生阶段的学生之中，来自大陆学生的比例一度高达 75%，这些学生，具有良好的学习能力，熟悉内地，在香港学习后，利用香港和国际接轨的大学资源，掌握科技，然后回到大湾区创业。与香港的市场容量有限不同，中国拥有庞大的市场，有利于项目的产业化，诸如大疆、商汤、思谋、正浩等都是非常好的例子。这种分工协作的模式，给私募股权投资带来了巨大的便利，从早期的香港孵化，到中期的大湾区内地落地，再到香港的资本市场或国内的资本市场上市，完成一个成功的闭环。

大湾区私募股权投资从制度到实践的可喜进展，无疑为未来大湾区私募股权的融合发展创造了条件，融合发展很大程度上还取决于中央《关于金融支持粤港澳大湾区建设的意见》相关配套措施的制定与实施，当然融合发展必须多赢，放下狭隘的本土意识，树立大局观念才能真正做到融合发展。

Hong Kong will remain the financial centre in the Greater Bay Area with its differentiating advantages in attracting international financial institutions. The Mainland part of the Greater Bay Area including Shenzhen and Guangzhou has secured its status as the go-to hub for technology enterprises. The division and coordination of roles of the three locations can offer different investment opportunities in different stages and domains.

4. That Hong Kong is deemed a centre of innovation and technology for the first time in the 14th Five-Year Plan has drawn attention and some scepticism. Yet the logic is quite clear: over the last decade or more, Hong Kong has utilized its comparative advantages in university resources to attract a large number of outstanding students from Mainland China – as high as 75% of post-grads at one point. These students are capable learners, familiar with the Mainland, and many of them return to the Greater Bay Area to start businesses after mastering their technology domains and utilized the internationally-linked university resources in Hong Kong. Contrary to the limited market size in Hong Kong, the vast size of the Mainland China market helps commercialization of their ventures. DJI, Sensetime, SmartMore and EcoFlow are great cases in point. The division of roles within the Greater Bay Area creates a virtuous circle for private equity investing, with incubation taking place in Hong Kong, growth capital in the Mainland part of the Greater Bay Area, and IPO listings in either in Hong Kong or in the Mainland.

The good progress of private equity investing in the Greater Bay Area from policy to deployment has created favourable conditions for the convergence of the development of the private equity industry within the Greater Bay Area. This is encouraging. However, its ultimate success will depend on the effective and timely implementation of the policies recommended in the Opinions. The “big-picture vision” of the Opinions stimulates a win-win mentality that can overcome parochial mindsets which could otherwise limit the successful development of private equity investing in the Greater Bay Area.

Shuang Chen, JP, Founding and Managing Partner, APlus Partners

Mr. Chen was the Executive Director, Chief Executive Officer and Chairman of the Management Decision Committee of China Everbright Limited (0165. HK). Mr. Chen is currently a non-official member of the Governance Committee of Hong Kong Growth Portfolio, a member of the Board of Director of Hong Kong Science and Technology Parks Corporation, a member of the Exchange Fund Advisory Committee's Financial Infrastructure and Market Development Sub-Committee of the HKMA, a member of HKTDC Mainland Business Advisory Committee, a visiting professor of East China University of Political Science and Law. Mr. Chen has over 28 years of experience in commercial and investment banking.

Base Erosion and Profit Shifting – BEPS 2.0

Darren Bowdern, Head of Alternative Investments, KPMG China
Nigel Hobler, Partner, Private Equity Tax, KPMG China
Ivor Morris, Partner, Real Estate Tax, KPMG China

There have been significant changes in the international tax landscape with respect to information sharing and combatting harmful tax practices. With the first phase of reforms now largely completed, in October 2020 the OECD released blueprints for further changes, known as BEPS 2.0. These proposals could fundamentally change the way in which multinational corporations structure their operating models and investment holding structures, and thereby how they allocate capital and investment going forward.

The second phase of BEPS consists of two pillars. The first pillar looks at the allocation of profits in consumer facing businesses and is unlikely to affect most investment funds directly. The second pillar introduces the concept of a global minimum effective tax rate. The minimum rate has not yet been set, but it is likely to be between 10% and 15%.

Where a jurisdiction is taxing profits below the minimum rate there will be mechanisms allowing other jurisdictions to charge a top up tax, either at the parent entity level, or by way of a withholding tax on intercompany payments.

The BEPS 2.0 proposals will have an impact on the global asset management industry. On a positive note, most investment funds (including pension funds and sovereign wealth funds) should be carved out of the proposals. The OECD has recognized the principle of tax neutrality for investment funds and excluded most from the proposed minimum tax rules, although corporate groups into which the funds invest will remain subject to the new rules.

However, there remains a degree of uncertainty with respect to some common investment fund structures. Further, fund management activities are not carved out, and therefore, larger fund manager groups may fall within the scope of the new rules.

Investment Funds and Collective Investment Vehicles

As collective investment vehicles, investment funds can take many different forms, depending on the particular investment strategy and asset class, and are typically structured so that the fund itself is not subject to direct taxation. Instead, tax is borne at the level of the investment and also by the investors on their investment returns from the fund. In other words, they are designed to put investors in the same position as if they had invested directly.

Whilst the proposals look to exempt the minimum tax rules applying to investment funds, conditions will apply. In particular, the funds must be:

- regulated

- pooled investment arrangements held by more than one unconnected investor (unless the sole investor is itself excluded from the minimum tax rules)
- managed by investment professionals on behalf of investors
- designed to generate income or gains for investors or act as a protection against particular events
- required to distribute profit or a return of capital to investors based on their contributions.

It is likely that most funds investing in traditional asset classes, as well as funds covering private equity, real estate and infrastructure, should satisfy the conditions, and therefore, fall outside of the minimum tax rules.

However, some funds may fall outside the exemption. The principal exceptions are likely to be investment funds established by family offices or funds held within a wider consolidated group, which may not meet the pooling requirements. The OECD has noted that funds held by a multinational group may pose a problem and has asked for views on the matter in its consultation paper. The OECD seems particularly concerned to ensure that while the investment fund itself may be outside the scope of the rules, the multinational group's share of investment returns from the fund remains subject to tax.

The issue of regulation may also be of concern for some closed-ended private investment funds. One of the conditions will be that the investment fund is subject to regulation, either at the investment fund or manager level. While most fund managers in Asia are licensed by the regulatory body in the jurisdiction in which they operate, not all managers of closed-ended funds need to be licensed. Further, in Asia, most funds use Cayman Islands vehicles which need to be registered with the Cayman Islands Monetary Authority. One key question is whether the current form of registration will be sufficient to meet the requirements for the carve-out.

Hong Kong's unified funds exemption specifically does not require certain funds to be regulated, although many are managed by a licensed manager. Most Singapore based funds are also likely to be regulated in some way, but

there will be exceptions and fund managers will need to review the details of their fund to ensure they fall within the exclusion.

The exemption will also apply to wholly owned (or almost wholly owned) investment holding companies of an investment fund, provided they are not engaged in a commercial trade or business. Holding companies held by more than one investment fund or other excluded investors (eg, sovereign funds or pensions funds) would also qualify for the exemption, but joint ventures with other investors would not – this may mean care will be needed when entering into joint venture arrangements with third parties.

For investment funds that are not carved out, it is still possible that the impact of the proposed new rules may be limited. Dividends and gains from non-portfolio investments in shares will not be included in the minimum tax calculations. Further, consolidated revenue of EUR 750 million is required in order for a group to fall within the minimum tax provisions, and where accounts are being drawn using investment accounting rather than consolidation then the threshold is unlikely to be met.

Fund Management fees

Unlike the investment fund vehicles, investment managers are not carved out from the proposed rule. As such, fund managers' consolidated income in excess of EUR 750 million will potentially be within the scope of the new rules. This is likely to mean that asset managers of sufficient size will need to consider the impact the new rules will have on their global profits.

Management and other fees would generally be expected to be caught by the new rules. To the extent that fund managers are currently recognizing substantial amounts of fee revenue either in low tax jurisdictions like the Cayman Islands, or taking advantage of incentives as in Singapore, there is a risk that top up taxes will be imposed in other higher tax jurisdictions within the group.

Many asset managers also derive income in other ways more directly linked to the investment. These may include co-investment returns, in the form of dividends or gains, or carried interest. In earlier drafts of the proposals, it had appeared that there might be a blanket exemption for dividends and gains on the disposal of shares, but it now seems that this will only apply above certain ownership thresholds. The amount is still to be determined, although it is likely to be something in the region of 10-20% of total share capital. The structuring of co-investments may need to be considered carefully – while there may well be anti-avoidance provisions to prevent taxpayers artificially meeting the ownership threshold, certain structures for co-investments may start to be more tax efficient than others.

Carry, as ever, will be complicated. Different jurisdictions already have a range of different approaches and incentives to the taxation of carry, although there does seem to be widespread recognition that it has many elements of an investment return. As with co-investment, the form of the carry (eg, distribution vs fee income) may make a big difference to how clearly it falls within any exemptions for dividends or capital gains, especially with regard to meeting ownership thresholds. Similarly, differences may arise according to whether the return is asset-by-asset or pooled, the details of clawback arrangements and so on. Final rules will be needed before a definitive view can be formed.

It is worth remembering though, that the rules only apply to groups of companies, so payments to individuals will not be affected. This may also have an impact on preferred remuneration strategies.

Subject to tax rule

The global minimum tax rules will be supplemented by a subject to tax rule. This will allow jurisdictions to override their treaty rates and impose top up tax where certain types of income (mainly passive income such as interest and royalties, but also certain service fees) are not sufficiently taxed.

Whilst investment funds, pension funds and sovereign wealth funds are generally intended to be carved out, the OECD paper acknowledges that there are still many points to be ironed out.

Conclusion

While investment funds are broadly carved out as excluded entities, the proposals are still in the consultation stage and fund managers will need to carefully monitor developments. It will be important to review the impact of any changes to ensure their arrangements are carved out (particularly where the fund is part of a multinational corporation), to identify any additional tax leakages and to see if there is any way of mitigating these.

Family offices, in-house funds, unregulated funds and joint venture arrangements may face particular difficulties.

Fund managers who meet the income thresholds may find that their fund management returns become subject to the minimum tax rates. Now is a good time to start modelling the potential impacts of the changes and to understand where additional leakages may arise.

The consultation period for the current proposals ended on 14 December. The OECD hopes to agree the two pillar proposals by the middle of this year.

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