Hedge Fund Law Report
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Fund Formation

Primary Regulatory and Business Considerations When Opening a Hedge Fund Management Company Office in Asia (Part Two of Four)

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Many hedge fund managers based in the U.S. or Europe have considered opening an office in Asia, but few are conversant with the benefits and burdens of the various Asian jurisdictions, and fewer still are familiar with the specific steps necessary to open an Asian office. To address this information gap, Maria Gabriela Bianchini, founder of Optionality Consulting, is publishing a four-part series in the Hedge Fund Law Report.

The first article in this series identified factors that hedge fund managers should consider in determining whether to open an office in Asia and compared the relative merits of Hong Kong and Singapore as locations for an office. See "Primary Regulatory and Business Considerations When Opening a Hedge Fund Management Company Office in Asia (Part One of Four)," Hedge Fund Law Report, Vol. 4, No. 43 (Dec. 1, 2011). This article – the second in the series – discusses technical steps and considerations for the actual process of opening an office in either Hong Kong or Singapore. Many of these steps are applicable to the establishment of any new office outside of a manager's home jurisdiction, but they are discussed in this article in the context of an Asian office opening. Part three of this series will discuss the changing regulatory landscape affecting managers in Singapore and part four will conclude with a discussion of Hong Kong.

Decide on the Point Person(s) to Launch the New Office

The very first step, which is critical, is deciding who should be responsible for the setup of your new office. Frequently, an investment analyst or a business development specialist is sent over to "set up" the office. However, making this decision will cost your business time and emotional resources. The process of setting up an office properly is tedious and time-consuming, and the project is best handled, on the ground, by either a trusted in-house operational or legal point-person or by a trusted outside adviser. Sending over a research/investment/marketing person will inevitably lead to a longer set-up time with more emotional pain, as the process is likely to frustrate these people and distract from their jobs. In order to manage an Asian office opening to timeline, it is critical to have a decision maker in the time zone. Making decisions between 6 a.m. and 10 a.m. and again between 6 p.m. and 10 p.m. is inefficient, hinders normal job responsibilities, and without being able to connect with what is happening on the ground, little issues easily spiral out of control. The most efficient processes are those run from Asia, on Asian time.

Engage Accountants for a Transfer Pricing Study and Tax Analysis

In order to compensate your team and allocate appropriate cash flows into your new subsidiary, you will want to know exactly how much cash you can direct to your new Asian operation. Therefore, at the time you decide to open an office in Asia, or any non-home country jurisdiction, it is imperative that you quickly engage an accounting firm to do a transfer pricing study and write a report. What is a transfer pricing study? It is essentially a diagram of your firm, assigning a weight to each position in the firm and its relative contribution to total revenues. It therefore serves as a guideline to the percentage of total firm revenues that is attributable to a new subsidiary. A transfer pricing study done correctly can take a few months. You will need to make representations to the transfer pricing team, and they may undertake a mini-diligence exercise in your offices to understand the technicalities of your current operations. You will need to review their drafts for factual inaccuracies and approve the final report. When legal documents papering the new sub-advisory entities are drafted (see below), they will need to track the transfer pricing study to ensure that the structure is robust. Never forget that both Hong Kong and Singapore are low-tax jurisdictions, often considered tax havens, and it is likely that the entire structure may be reviewed by the relevant tax authorities in your home country. In the current political environment, failing to spend the resources and time to put into place a robust tax and transfer pricing analysis to support any profit and loss movement to Asia is an unfavorable risk/reward trade off.

Engage Your Prime Broker(s)

All prime brokers have units within them called the "business consulting" groups. In Asia, the business consultants are extremely proactive on issues relating to management company set up. They can provide you with the basics on regulatory process, budget ranges, contact information for service providers in the region, and will sort through their talent databases for you. They can also refer you to other service providers. In one colorful instance, a business consultant figured out how to move a hedge fund manager's dog, minimize the quarantine period and reunite manager and dog efficiently. Relationships are closer in Asia, so when in doubt, a call to your prime broker may find you an answer, even if it's an answer to a question you did not expect to ask.

Staffing

As mentioned in part one of this series, talent development plays prominently into any decision regarding an office in Asia. Given the long lead times needed to source talent that is both a cultural and historical fit for your organization, starting early to identify potential needs will help avoid a situation where an office opening is delayed or other objectives remain unmet due to lack of talent.

Decide Whether to Use a Serviced Office or Lease a Standard Office Space

Many companies, regardless of industry, often like to dip a proverbial toe in the water of a new market before committing to that market. In Asia, serviced office offerings abound. If opening with only one or two employees, this route is tempting. It is easy as it enables one to be on the ground instantly.

Although serviced offices are an option, in this increasingly monitored and regulated environment, one should ask oneself whether one is comfortable with a serviced office today. Sooner or later, you will face the issue of server and rack space and will need to either (1) get comfortable with data sharing or (2) decide that you must have your own servers. In addition, you need to ask whether you are comfortable with other security issues such as shared printing facilities, co-mingled kitchen and public spaces and an inability to guarantee confidentiality at the same levels that investors may expect.

On the other hand, finding space in Asia that is "hedge fund sized" often proves to be quite a challenge. The typical branch office needs relatively limited space, perhaps between 1,000 and 3,000 square feet. However, Asian developers, hoping to attract large multinational corporations, often lease office space by the floor, which is neither desirable nor cost effective. The cost of refitting an office, ensuring it is "IT ready" and the cosmetic build out can be quite time consuming and will certainly delay time to open. On the other hand, such solutions, while draining initially, have the advantage of ensuring that privacy and confidentiality of your firm are maintained at company-wide levels.

In addition, cost may be a consideration. Serviced offices are "serviced." Every aspect of the office, from forwarding phone calls to assisting with IT repair, is charged at a significant premium to the same service/opportunity if you were doing it yourself. Knowing upfront that the cost of a serviced office may be overwhelming when all of the "nickel and diming" is added to the bill is an important feature as you are committed to their facilities for at least a year, and more if you do not give proper notice. Controlling the look and feel of your office, as well as knowing that the costs of construction are lower in Asia (because of lower labor costs) and the balance may tip towards opening your doors directly. The leases tend to be multi-year leases, but if you are committed to the region, this may be the best way to control your costs as they will be transparent.

An alternative that occasionally presents itself is the "pre-kitted" office. Managers do go out of business, others expand, and if you have a few months of patience, you may find yourself in possession of an office that is ready for you to move in, complete with server closet, enough power outlets for all of your computers and even some equipment. Hong Kong also has some spaces designed for a smaller tenant. In Singapore, some companies take space and sublet to others. These options are great alternatives for the manager with patience and do appear on the market from time to time.

Create an IT Roadmap

The single most likely place for an office opening to fall apart is with IT and communications systems. Even in a situation where the only decisions that you think you are making is to replicate your existing systems in your subsidiary and link it back to your main servers in your home office, do not underestimate the number of glitches that can develop. Many project managers in Asia are extremely literal in how they take instructions. Do not expect that your phones will roll to your receptionist, or that your e-mails will flow into your inbox. Start early, take ownership and stay on top of technology to avert disaster. Create a detailed roadmap of what kind of user experience you want to have in your new office and what your budget limitations are. For example, some of the highly automated systems that traders prefer are the kind of licenses that you do not need or want when testing a new office, so your execution trader may just have to be happy with older systems that get the job done a little less elegantly. You can always upgrade later once the profit and loss is in the black.

Form the Company and Open a Bank Account

With the groundwork laid, it is time to create a company and fund it. There are many low cost providers who can form a company and create resolutions authorizing the opening of a bank account. The actual process of opening a bank account can be more onerous in Asia given heavy reliance on documentation. In order to smooth the process, be sure to have the address information of the company's registered office in hand, along with copies of all formation documents and the signed resolutions authorizing the opening of the account and its initial signatories. Capitalize the company at least to the minimum statutory amount (each jurisdiction is different on its regulatory capital requirements) and the new management company will exist.

Prepare Regulatory Forms

In preparing the regulatory forms, keep in mind that both Hong Kong and Singapore are long on form. Prepare your paperwork in advance. Review and update your global organization charts. Be sure to have separate charts for beneficial ownership and reporting lines. Keep your formation documents in certified copy on hand and have multiple certified copies of the passports for principals. Update your DDQ. Update your compliance manual. Verify your current level of indemnity insurance. Follow the Boy Scout motto: be prepared. Understand that the regulators are likely to interact with you during the licensing process and may not review any of the materials you give them, so prepare to undertake an educational process in the filing. Although you may have provided the data already, be patient and direct the regulators to the answers they seek.

If possible, go meet with the regulators in person. Unlike in the United States, the regulators in Asia have some contact with their regulated entities. Take advantage of this to schedule a meeting and preview your company with them. It may cause the actual licensing process to run much more smoothly.

Prepare Legal Documents to Sub-Advise Existing and New Entities

With the company in existence, your advisory agreement and existing counterparty documentation may need to be revised. At the very least, all of the advisory contracts will need to be amended to (1) add the new group entity and (2) implement the recommendations of the transfer pricing study. Note, if the transfer pricing study was not initiated early in the process, it will hold up the opening at this point.

If it is intended that the Asian office will include a trading desk, then trading counterparties will seek to conduct diligence on the new entity and to see the executed advisory agreements. They may then ask you to fill out supplemental paperwork authorizing the new entity to execute trades on behalf of your fund(s). Note that at this point, your counterparties may require a new KYC process to onboard the new entity. It is helpful to have a stack of pre-certified copies of passports for all relevant decision makers such that you are not delayed in your opening process by the fact a key executive is on holiday.

Insurance, New Employment Agreements, Benefits, Health Insurance

Given how many balls are in the air, it is easy to overlook insurance and other employee benefits issues. However, for your new office to function properly, it is important to have property insurance, umbrella coverage that includes your new office, errors/omissions insurance, workers compensation insurance and health insurance for the new employees. Health insurance especially may create unique challenges for your organization. Only a handful of U.S.-based insurance companies have comprehensive plans that include international expatriate coverage. However, to open a standalone office without being able to account for the existing health plan risks your employees losing benefits whilst overseas due to the fact that the small office lacks the leverage to command the same benefits as the domestic plan. Although this article discusses insurance toward the end of a chronological list of steps in opening a local office in Hong Kong or Singapore, if possible, the review of existing insurance and whether it covers a manager's soon-to-exist Asian subsidiary should begin early. In fact, take it as an opportunity to review your insurance across the firm. If you haven't regularly updated it, you may find that you were adequately insured when you started, but under your current structure, you need to increase the size of your policy. The quality of the brokers varies significantly in Asia, as does the knowledge of the people you will be asking. Be persistent. Looking for Asian offices of U.S.-based insurers is the fastest route toward comprehensive "American Style" full cover insurance. Don't get caught behind. See generally "Hedge Fund D&O Insurance: Purpose, Structure, Pricing, Covered Claims and Allocation of Premiums Among Funds and Management Entities," Hedge Fund Law Report, Vol. 4, No. 41 (Nov. 17, 2011).

The Fun Stuff

Finally, a word about the fun stuff. If you decide to open up a new physical space, hiring the interior design team and overseeing the build-out is very satisfying. There are a ton of contractors and interior designers in Asia, and you will likely see for yourself how fast the process can go. A word to the wise, however. Like many other parts of this discussion, personal oversight is critical. There are many stories of build-outs gone bad because the company let the contractor execute without guidance. A favorite story illustrating this principle is the "fire pole" episode. Somehow, a contractor managed to build a giant pole, which looked like a fire pole, into the middle of the office. Suffice it to say that the manager was running a professional organization of a different sort, and paid a lot of money to have the pole removed and the office re-designed.

Summary

Opening an office in Asia is in turns exiting, frustrating, demoralizing, infuriating and inspiring. At the end of the day, the lights will go on, the screens will light up, and the markets will open. If you've done your legwork, when that day comes, you'll have the great feeling of the "high five" when the team calls back to the home office and brags about the new digs. You really can inspire the same culture as back home. And if anyone needs to source a foosball table in Asia, you know where to reach me, I know who to call. . . .

Maria Gabriela Bianchini is the founder of Optionality Consulting, a Singapore-based consulting firm specializing in assisting hedge funds with regulatory and operational issues. Bianchini began her legal career at the United States Securities and Exchange Commission, where she worked on large scale capital markets transactions and contested mergers and acquisitions. Following her tenure at the SEC, Bianchini was based in New York, where, as an attorney with Schulte Roth & Zabel LLP, she advised on significant issues affecting the alternative asset industry. She was instrumental in implementing the firm's SEC registration program for hedge funds in 2005. Additionally, she was a primary contributor to the American Bar Association's advice to the SEC on how to handle the U.S. hedge fund industry after the SEC's 2005 rule requiring registration of hedge fund managers was overturned in federal court. See "Application of Brochure Delivery and Public Filing Requirements of New Form ADV to Offshore and Domestic Hedge Fund Managers," Hedge Fund Law Report, Vol. 4, No. 11 (Apr. 1, 2011) *(in particular, the discussion in the article of the July 31, 2006 letter from the ABA to the SEC's Division of Investment Management). She was a primary adviser to one of the most contentious proxy contests to transpire in the past decade and provided critical advice on trading strategy to global hedge funds during and after the global financial crisis. After Schulte, Bianchini became the Chief Operating Officer of a London-based global investment manager, and spearheaded its global expansion, including opening offices in New York and Singapore. She began her career in Asia, specializing in the political economy of mainland China. She speaks Mandarin Chinese, is admitted to the bars of California, New York and Washington DC, and additionally is a solicitor admitted to the rolls of England and Wales.*

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