REGULATORY NEWSLETTER

2024 Vol.5

Welcome to the fifth edition of our Regulatory Newsletter. In this issue, we reflect on the past month's significant developments within the financial industry, focusing specifically on the evolving landscape that professionals in risk management and compliance face. We aim to provide a concise summary of the latest regulatory updates that have occurred in Hong Kong, ensuring you stay informed and ahead in your respective fields!

REGULATORY UPDATES

Circular to Licensed Corporations which are Participants of The Stock Exchange of Hong Kong Limited or Hong Kong Futures Exchange Limited - Licence Holders Insurance Scheme for Exchange Participants

23 April 2024

This circular outlines the insurance scheme arrangements for licensed corporations under the Securities and Futures Ordinance for the scheme year from April 1, 2024, to March 31, 2025. It applies to participants of The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited, categorized under Type 1 and Type 2 regulated activities respectively.

Key points include:

Insurance Requirements: Licensed corporations must maintain insurance against specified risks as outlined in the Securities and Futures (Insurance) Rules, with an approved master policy.

Master Policies Arrangement: Two master policies have been arranged by Marsh (Hong Kong) Limited, covering different categories of licensed corporations. These policies are co-underwritten by various syndicates and companies, including Lloyd’s Syndicates and Allied World Assurance Company.

Coverage Details: Each insured participant is covered up to $15 million per regulated activity per year with a deductible of $3 million per claim. Coverage specifics are detailed in separate documents distributed by Marsh.

Premium Allocation: The Industry Working Group (IWG), supported by Marsh, continues the adopted premium allocation methodology from the previous year. The gross premium is split into a minimum basic premium (20% of the gross premium) and a variable premium (80% of the gross premium) based on annual turnover.

Premium Adjustments: Premium loading applies to participants based on claims made in the preceding year, with additional premium adjustments based on the amount and recency of paid claims. Category 2 participants may receive a premium discount based on their annual turnover percentage relative to the market total.

Scheme Administration: Marsh is responsible for implementing the scheme, allocating premiums, and distributing necessary insurance documentation.

For details, please refer to the link below

View Circular

Joint circular to intermediaries
Findings of concurrent SFC-HKMA thematic review of the distribution of non-exchange traded investment products

18 April 2024

During a concurrent thematic review of the distribution of non-exchange traded investment products by intermediaries, the Securities and Futures Commission ("SFC") and the Hong Kong Monetary Authority ("HKMA") identified some issues on intermediaries' practices in performing product due diligence ("PDD") and suitability assessment, providing information to clients and ensuring investment products are in the best interests of the clients. The intermediaries concerned were required to undertake remedial action to address the issues identified.

Key observations

1. Many intermediaries would assign risk rating to investment products as part of PDD for matching with client's risk tolerance level, either calculated using their internal risk-scoring mechanisms or based on the nature of underlying investments. The regulators noted that some intermediaries had overlooked certain key features and risk factors in their PDD assessment methodologies which could directly or indirectly impact the risk return profiles and growth prospect of the investment products. In some cases, intermediaries did not consider during the assessments the pay-out and characteristics of a leveraged structured forward contract, credit events relating to the product issuers, heightened market and industry risks, or adverse economic and political environments.

2. These intermediaries could run the risk of making inappropriate recommendations to clients if the risk return profiles of the products were not adequately assessed and accurately reflected in the product risk ratings used for the suitability assessment. Under such circumstances, the ability of intermediaries to fully inform clients the nature and extent of risks of the products would also be adversely affected. The risk would be further aggravated if the investment products, such as structured products, have leverage features which could amplify potential losses.

3. Structured products were the most prevalent type of non-exchange traded investment products sold by intermediaries. Among the structured products, accumulators and decumulators were the most popular products sold. Accumulators and decumulators are derivative products associated with significant investment risks. Investors typically risk a loss up to the notional amount of the contracts, and could only achieve positive returns if the price of the underlying asset moves within the defined range between the strike price and the knock-out price that was set to limit the maximum amount of profit. The loss could be unlimited in some cases, for example, where the investors of decumulators have to bear the loss when the price of the underlying asset goes up.

4. Clients would not be able to understand the characteristics of accumulators and decumulators should the intermediaries merely hand over the product literature to the client, ask the client to read them, or read them to the client without any explanation. In one case, a salesperson was unable to explain why investors could buy shares at a price lower than the market price with an accumulator contract. He could only read out the value of its "discount" compared to market price, its knock-out clauses and potential losses from the relevant term sheet. It is therefore imperative for intermediaries to develop thorough understanding of structured products during PDD and provide adequate training to staff to ensure that they are fully conversant with the characteristics, nature and extent of risks of the products recommended to clients.

5. Intermediaries are reminded to exercise due skill, care and diligence in selecting investment products for different risk categories of clients and arrive at an assessment of the products taking into account information that is appropriate and reasonably available for a fair and balanced assessment. Failure to do so could severely inhibit intermediaries' ability in helping clients to make an informed investment decision.

6. The regulators also wish to remind all intermediaries of their obligations to, among other things –

    (i) give due consideration to all the relevant circumstances specific to a client when assessing the suitability of a product to the client; and

    (ii) disclose all relevant transaction related information, and ensure that information provided and any representations made are accurate and not misleading.

7. The observations from the concurrent thematic review on licensed corporations are set out in Annex 1 and those on registered institutions in Annex 2. Intermediaries are expected to review their policies and procedures to address any issues relevant to their firms with a view to improving compliance, having regard to relevant annexes.

8. Should you have any questions regarding the contents of this circular, please contact Ms Nicole Cheung on 2231 1492 or your case officer at the Intermediaries Supervision Department of the SFC or Ms Eloise Pun at the Banking Conduct Department of the HKMA on 2878 1903.

View Circular

Joint Circular on Anti-Scam Consumer Protection Charter 2.0

10 April 2024

To help combat digital frauds and scams, the Hong Kong Monetary Authority (HKMA), the Insurance Authority (IA), the Mandatory Provident Fund Schemes Authority (MPFA) and the Securities and Futures Commission (SFC) (in alphabetical order, hereafter called "four financial regulators") are committed to enhancing public awareness of safeguarding their bank, credit card, investment, insurance and mandatory provident fund (MPF) account and other key personal information. In this respect, the four financial regulators jointly invite their regulated entities which primarily serve retail customers (see below for details of scope) to adopt the Anti-Scam Consumer Protection Charter 2.0 (the Charter 2.0).

On the back of increasing prevalence of digital frauds and scams, the financial sector has been taking various actions, including enhancing fraud monitoring and data security management, to help guard against such crimes. As consumers also play a crucial role in prevention of frauds and scams, the four financial regulators now make joint efforts in raising consumers' awareness of the need and their ability to protect themselves against illegal digital acts.

Riding on the Anti-Scam Consumer Protection Charter launched in June 2023[1], the Charter 2.0 aims at expanding the participation of institutions to also cover:

a) authorized institutions under the Banking Ordinance (Cap. 155) carrying on retail banking business;
b) authorized insurers and licensed insurance broker companies under the Insurance Ordinance (Cap. 41) carrying on long term insurance business and general insurance business and focusing on retail customers;
c) MPF approved trustees and principal intermediaries under the Mandatory Provident Fund Schemes Ordinance (Cap. 485); and

d) licensed corporations under the Securities and Futures Ordinance (Cap. 571) carrying on regulated activities and focusing on retail customers.

Participating institutions are expected to carry out the following activities in support of the Charter 2.0:

- Commit not to send any instant electronic messages (e.g. SMS, WhatsApp, WeChat, etc) to customers with embedded hyperlinks to acquire bank, credit card, investment, insurance and MPF account or other key personal information online, unless arising from requests by the customers;
- Work together in raising public awareness of digital frauds and scams. This will include sending through their suitable channels (such as corporate websites, mobile apps, etc), publicity and promotional material, a key message of "Beware of scams! Do not provide bank, credit card, investment, insurance and MPF account or other key personal information via hyperlinks embedded in suspicious messages purported to be coming from our institution!" to their customers and the public to facilitate awareness of such frauds and scams;
- Provide contact information on their suitable channels (such as corporate websites, mobile apps, etc) for customers to make enquiries (e.g. on verifying the identities of the message senders or authenticity of the messages); and
- Provide relevant training to their frontline staff (including sales and customer service staff) so that they will be able to handle customer enquiries and convey anti-scam education messages as appropriate.

While the above principles may be more relevant to retail-facing financial institutions, other regulated financial institutions are also strongly encouraged to follow the above principles as far as practicable subject to their business models.

Regulated financial institutions which have not yet indicated their participation but would like to adopt the Charter 2.0 may indicate their interest to or enquire with the following contacts on or before 28 June 2024. A reply template for the regulated financial institutions to indicate their participation in the Charter 2.0 can be found in the Annex.

View Circular

ENFORCEMENT NEWS

SFC issues restriction notices to two brokers to freeze accounts of client involved in suspected corporate misconduct

24 April 2024

The Securities and Futures Commission (SFC) has issued restriction notices to Futu Securities International (Hong Kong) Limited (Futu) and Interactive Brokers Hong Kong Limited (Interactive), prohibiting them from dealing with or processing assets held in their client accounts which are owned by a former member of the board of directors of a corporation listed on the Main Board of the Stock Exchange of Hong Kong Limited at the material time.

In this connection, the former member of the board of directors is suspected of committing misconduct and breaching his duty towards the corporation.

The SFC is not investigating Futu or Interactive, both of which have cooperated with the SFC's investigation. The restriction notices do not affect them or their other clients.

The restriction notices prohibit the two brokers, without the SFC's prior written consent, from disposing of, dealing with, or assisting, counselling or procuring another person to dispose of or deal with any assets in those accounts up to the amount stated in the notices. They are also required to notify the SFC if they receive any instructions regarding the prohibitions specified above.

The SFC considers that the issue of the restriction notices, which preserves the assets in those accounts, is necessary to ensure that there will be funds available to meet any potential order by the Court in legal proceedings that may be brought by the SFC, and is desirable in the interest of the investing public and in the public interest.

View News

Case consolidation for first ramp-and-dump criminal prosecution at District Court

25 April 2024

The District Court today granted an application by the Department of Justice to consolidate an existing ramp-and-dump case involving a highly sophisticated syndicate with another case transferred from the Eastern Magistrates' Courts.

The three defendants of the consolidated case – Mr Stevens Yip Chi Fai, Ms So Lung Ying, and Mr Lau Ka Wing – were charged with conspiracy to employ a scheme with intent to defraud or deceive in transactions involving securities following an extensive investigation by the Securities and Futures Commission. Yip, So and Lau are suspected core members of the syndicate.

All three defendants appeared at the District Court today. No plea was taken and the case was adjourned to 25 July 2024.

The Court granted bail to Yip, Lau and So on these conditions: (i) not to leave Hong Kong; (ii) surrender all travel documents; (iii) pay cash bail of $500,000, $400,000 and $50,000 respectively and (iv) reside at the reported residential address and inform the police of any change of residential address.

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ComplianceDirect Consulting Limited

Address: Unit 2, 10/F, Cheong K. Building, 84 & 86 Des Voeux Road Central, Central, Hong Kong

Phone: 2606 1800

Website: www.compliancedirecthk.com