REGULATORY NEWSLETTER

2024 Vol.1

Happy New Year!

2024 comes with the good news of reopening of the city's border. While we are stepping into the year of dragon – a year of recovery and resilience, ComplianceDirect wish you a year full of love, happiness and success. As always, we would endeavour to provide you our professional consultation and compliance services.

Let's begin 2023 with our Regulatory Updates from the SFC!

REGULATORY UPDATES

Circular on SFC-authorised funds with exposure to virtual assets

22 Dec 2023

The Securities and Futures Commission (SFC) of Hong Kong has issued a circular detailing the guidelines for the authorization of investment funds that have more than 10% of their net asset value (NAV) in virtual assets (VAs) for public offerings. This circular replaces the one issued on October 31, 2022, regarding Virtual Asset Futures Exchange Traded Funds.

With the rapid global evolution of the VA market, the SFC has seen an increase in the variety and number of investment products with VA exposure, including exchange traded funds (ETFs). These products are gaining popularity among retail and professional investors in Hong Kong. In response, the SFC has established frameworks to allow certain VA products to be offered to the public, incorporating necessary investor protection measures. Since October 2022, the SFC began accepting applications for ETFs that primarily use futures contracts to gain VA exposure. Moreover, a licensing regime for virtual asset trading platforms (VATPs) became operative in June 2023, which lets investors directly access large-cap spot VAs under specific conditions.

The circular outlines that SFC-authorised funds can invest directly in spot VA tokens available on SFC-licensed VATPs or gain indirect exposure through other regulated means such as futures or other exchange-traded products. The funds must adhere to the overarching principles and the UT Code from the SFC Handbook, along with meeting additional criteria specified in the circular and a joint circular concerning intermediaries' virtual asset activities.

The management companies of these funds must have a good regulatory compliance record and at least one experienced staff member in managing VA or related products. Investments must be limited to VAs that are tradable on SFC-licensed VATPs by the Hong Kong public. The funds should not have leveraged exposure to VA at the fund level and must demonstrate liquidity and manageable roll costs for VA futures.

Transactions in spot VAs should be conducted via SFC-licensed VATPs or authorized financial institutions adhering to the Hong Kong Monetary Authority’s regulations, allowing both in-kind and in-cash subscriptions and redemptions. The trustee/custodian of the funds must ensure that VA holdings are segregated, stored securely (primarily in cold wallets), and that access to seeds and private keys is highly restricted and backed up.

Valuation of spot VAs should be based on an indexing approach that reflects trade volume across major trading platforms. Management companies must ensure all service providers are competent and prepared to support the funds. The offering documents must disclose the investment limits and key risks of the funds' VA exposures, and the management companies are required to conduct investor education before launching the funds.

Distribution of these funds must follow the requirements set out in the Joint Circular. The SFC reserves the right to impose additional requirements or conditions as necessary. Applications for authorization of funds with over 10% NAV in VAs, or existing funds intending to increase their VA exposure beyond this threshold, require prior consultation and approval from the SFC. For clarifications, the SFC advises contacting the Investment Products Division responsible for overseeing the funds.

View Circular

Joint circular on intermediaries’ virtual asset-related activities

22 Dec 2023

This circular will supersede the joint circulars on intermediaries’ VA-related activities issued on 20 October 2023 and 28 January 2022.

In June 2023, the SFC enacted a new licensing framework for Virtual Asset Trading Platforms

(VATPs) by revising the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO). Under this updated framework, VATPs that are licensed are permitted to offer services to the general public, provided they implement stringent measures to protect investors. For further information, refer to our preceding discussion on this subject.

Given these developments, the SFC, in conjunction with the Hong Kong Monetary Authority (HKMA), has revisited their policies concerning the participation of intermediaries in virtual asset-related activities (VA-related activities) and has addressed questions from the sector about increasing retail investors' access to these services via intermediaries.

The Circular addresses the following areas:

- Distribution of products related to virtual assets,
- Delivery of services involving virtual assets,
- Management of assets within the virtual asset space, and
- Advisory services concerning virtual assets.

View Circular

Circular in relation to the clearing and record keeping rules for the OTC derivatives regime – changes to the list of persons designated as financial services providers

1 Dec 2023

The revised list of persons designated as financial services providers (FSPs) for the purposes of the Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) Rules (Clearing Rules) is gazetted today, and becomes effective on 1 January 2024.

Licensed Persons are reminded that if their average total position in OTC derivatives during a Calculation Period reaches the corresponding Clearing Threshold, relevant OTC derivative transactions they enter into on and after the corresponding Prescribed Day, including those with FSPs must be centrally cleared in accordance with the Clearing Rules.

Please refer to the Clearing Rules and the Frequently Asked Questions on the Implementation and Operation of the Mandatory Clearing Regime for more information.

View Circular

Circular to Management Companies of SFC-authorised Exchange Traded Funds (“ETFs”) – List of Potential Events Triggering Ongoing Disclosure

29 Dec 2023

The Securities and Futures Commission (SFC) of Hong Kong has provided guidance to management companies of SFC-authorised Exchange Traded Funds (ETFs) detailing situations that might necessitate ongoing disclosure to both the holders of the ETFs and The Stock Exchange of Hong Kong Limited (SEHK). According to the Code on Unit Trusts and Mutual Funds (UT Code) and the Listing Rules, ETF providers must inform investors and the SEHK about significant events that could affect the assessment of the ETF's position or prevent a false market.

The guidance includes a list of potential events that, if materially impacting the ETF, should be disclosed. These events encompass changes in the ETF's replication strategy, collateral policy, or the financial or regulatory status of key operators, as well as the initiation of legal or disciplinary proceedings against the ETF's trustee, custodian, or management company. Other events requiring disclosure include changes to the underlying index or its calculation methodology, litigation against the ETF or its key operators, defaults or significant financial changes of derivative counterparties for ETFs using a synthetic replication strategy, cessation of market making, suspension of unit creation or redemption, changes in tax or regulatory policies impacting the ETF's net asset value, and material breaches of the ETF's constitutional documents.

Management companies must exercise their judgement on a case-by-case basis to determine the necessity and timing of such disclosures. While the provided list is not exhaustive, it serves as a guide to help management companies fulfill their disclosure obligations. For further clarification, management companies are encouraged to reach out to the assigned case officer at the SFC or HKEX.

View Circular

Circular to management companies of SFC-authorised unit trusts and mutual funds - Updated guidance on streamlined measures for SFC-authorised funds
22 Dec 2023

The Securities and Futures Commission (SFC) has introduced updated guidance to improve the operational efficiency of SFC-authorised funds. This guidance is part of the SFC's commitment to maintaining effective processes while safeguarding investor interests.

The updated guidance includes several streamlined measures:

For the appointment of new investment delegates, the process will be expedited, with "standard applications" for new funds and "simple applications" for existing funds processed more quickly. Additionally, the SFC has removed the requirement for prior approval when a fund appoints an investment delegate already managing other SFC-authorised funds.

For UCITS funds, the SFC has lifted the reporting requirement for pricing errors if there are no affected Hong Kong investors. There is also a simplified reporting process for breaches under the supervision of the home regulator, provided fund managers submit a standardized form to the SFC.

Regarding post-authorisation notifications, the SFC has streamlined the requirements, such as allowing notifications of fund suspensions on the fund’s website, requiring shorter notice periods for changes when all affected investors have consented, and eliminating the need for separate notices for the publication of a fund's annual report if the offering documents already include disclosures.

The SFC will no longer require prior approval for a reduction in a fund's derivative investments and has offered additional guidance on calculating net derivative exposure in their guide on financial derivative instruments.

The disclosure guidance in the application authorization guide for unit trusts and mutual funds is clarified as non-mandatory and should be used as a reference to assist in preparing fund offering documents.

View Circular

ENFORCEMENT NEWS

SFC issues restriction notice to China International Capital Corporation Hong Kong Securities Limited

8 Dec 2023

The Securities and Futures Commission (SFC) has issued a restriction notice to China International Capital Corporation Hong Kong Securities Limited (CICC), prohibiting it from dealing with or processing certain assets held in a client account which is related to suspected insider dealing.

The SFC is not investigating CICC. The restriction notice does not affect CICC's operations or its other clients.

The restriction notice prohibits CICC, without the SFC's prior written consent, from disposing of or dealing with, or assisting, counselling or procuring another person to dispose of or deal with, any assets in any way in the account up to a certain amount, including: (i) entering into transactions in respect of any securities; (ii) processing any withdrawals or transfers of securities and/or cash on the instructions of any authorized person of the account or by any person acting on their behalf; (iii) disposing of or dealing with any securities and/or cash on the instructions of any authorized person of the account or by any person acting on their behalf; and/or (iv) assisting another person to dispose of any relevant property or deal with any relevant property in a specified manner. CICC is also required to notify the SFC immediately if it receives any of these instructions.

The SFC considers that the issue of the restriction notice is desirable in the interest of the investing public or in the public interest.

The SFC's investigation is ongoing.

View News

SFC suspends Hau Bing Leung for 15 months

27 Dec 2023

The Securities and Futures Commission (SFC) has suspended the licence of Mr Hau Bing Leung, former account executive of Chee Tak Securities Limited (CTSL), for 15 months from 22 December 2023 to 21 March 2025.

The disciplinary action follows the SFC's earlier sanctions against CTSL and its responsible officer for internal control deficiencies and regulatory breaches.

The SFC's investigation found that, between 1 July 2018 and 5 March 2020, Hau had allowed a third party to operate the securities account of a client at CTSL without obtaining the client's written authorisation. The third party, a former client of Hau, had been verbally authorised by the client to make investment decisions and place orders in the client's securities account at CTSL. Hau and the third party also carried out personal trades in the client's securities account.

Hau's conduct exposed the client to potential loss from unauthorised trading and CTSL to potential liability in case the client disputes any of the trades in her account. Hau also prevented CTSL from properly monitoring the operation of that client's account and his personal trading activities.

In deciding the disciplinary sanction, the SFC has taken into account all relevant circumstances, including:

- CTSL did not have any relevant policy or procedure to require written third party authorisations for the operation of client accounts; and
- Hau has no previous disciplinary record with the SFC.

View News

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