

### What's inside?

SFC tightens regulation of investment-linked assurance schemes .....	1 - 3
Effective date looms for new Code on Pooled Retirement Funds .....	3
SFC brings first enforcement action against manager-in-charge .....	3 - 4
Mainland China briefing: Newly launched Beijing Stock Exchange issues implementation rules for QFIs .....	4
Hong Kong SFC licensing and compliance hints .....	5
Recent publications .....	5 - 6

## SFC tightens regulation of investment-linked assurance schemes

Scott Carnachan and Jack Hung

On 1 November 2021, Hong Kong's Securities and Futures Commission (**SFC**) published a [circular](#) to provide additional guidance to issuers of SFC-authorized investment-linked assurance schemes (**ILAS**) on the application of certain existing requirements under the Guidance on Internal Product Approval Process (**PD Guidance**) to ILAS (**Additional ILAS Guidance**). The SFC has also provided further guidance to ILAS issuers in section 4 of its [FAQs](#) relating to Investment-Linked Assurance Schemes to elaborate on the requirements under the Additional ILAS Guidance.

The Additional ILAS Guidance formulates further product design and disclosure enhancements, following a recent review of ILAS products on the market by the SFC.

Existing ILAS issuers have until 30 April 2023 to ensure that their SFC-authorized ILAS comply with the enhanced requirements under the Additional ILAS Guidance.

### What is required under the Additional ILAS Guidance?

The Additional ILAS Guidance is built upon the existing requirements on product design, fees and accountability throughout the product life-cycle under the PD Guidance. Key points are summarised below.

#### Product design

When determining the product features, ILAS issuers should consider, without limitation, the following to ensure that their ILAS products are designed fairly and deliver a fair outcome to the target market:

- the level of life insurance protection (e.g. whether and the extent to which the ILAS product provides insurance protection above the premium paid or payable similar to a term life insurance product);
- the fee charging model and structure (e.g. whether policy charges are calculated based on account balance or on a transaction-by-transaction basis) and overall fees and costs borne by an investor;

- the number and variety of underlying funds and fund houses for selection;
- the premium payment structure and level (e.g. whether single or regular premium payment, the premium payment amount and period); and
- product liquidity (e.g. whether any surrender charges may apply in the event of early policy surrender or partial withdrawal).

### Fees

ILAS issuers should ensure that the fees of their ILAS are fair, proportionate and commensurate with the insurance protection offered by the ILAS (when compared with other alternative products) throughout the whole policy term. In particular:

- Cost of insurance (**COI**) – ILAS issuers should ensure that in general the COI rates of an ILAS product are not higher than those charged by comparable alternative products (e.g. term life insurance products).
- Platform fee – Platform fee should be comparable to corresponding alternative products over the lifetime of the ILAS policy, and upfront charge (if any) should not significantly reduce the amount of premium available for investment and therefore lowering the surrender value and the death benefit of the ILAS policy in early years.
- Early surrender or withdrawal charge (**SC**) – ILAS issuers should seek to lower the SC and shorten the SC period depending on the level of insurance protection offered by the ILAS. In particular:
  - (i) An ILAS that provides low or minimal insurance protection is generally expected to charge a lower SC over a short period;
  - (ii) An ILAS with high insurance protection (comparable to other life insurance products) may charge a higher SC or with a longer SC period; and
  - (iii) Issuers should also assess whether investors will receive a comparable payout if they surrender after holding the product for a reasonable period of time as compared to holding comparable alternative products.

### Complex product features

ILAS issuers should ensure that the product features are not unduly complex when designing their ILAS products. ILAS issuers should avoid (a) features or terms which are unnecessarily complicated, incomprehensible or provide no (or limited) additional value to investors; or (b) using multiple variables or complicated formulas unnecessarily to determine the return or which render the policy difficult for investors to understand.

### Review and monitoring

ILAS issuers should conduct regular reviews of compliance with the PD Guidance and the Additional ILAS Guidance (based on the latest comparable alternative products available in the market) and submit a written confirmation of compliance to the SFC every two years for products that are on offer to Hong Kong public.

### Enhanced disclosure requirements

The SFC has also revised its illustrative template for ILAS product key facts statement to enhance the disclosure requirements relating to fees, including platform fee and SC.

### **When does the Additional ILAS Guidance take effect?**

The Additional ILAS Guidance took effect on 1 November 2021 (**Effective Date**), and applies to new ILAS for which applications for authorisation are submitted to the SFC on or after the Effective Date. All applicants are required to submit a written confirmation in the prescribed form to the SFC that the PD Guidance and the Additional ILAS Guidance have been and will be fully complied with.

A transition period of 18 months from the Effective Date (expiring on 30 April 2023) will be provided for existing SFC-authorized ILAS to comply with the enhanced requirements under the Additional ILAS Guidance.

### **Enhanced authorisation process for new ILAS applications and additions of investment choices**

To facilitate the processing of applications, the SFC has also published a circular on 1 November 2021 to introduce an enhanced process for applications for authorisation of new ILAS (**Enhanced Process**). The Enhanced Process is similar to the process the SFC adopts for applications for authorisation of unit trusts and mutual funds.

Under the Enhanced Process, a “two-stream” approach will be adopted, whereby new ILAS applications will be classified into a “Standard Applications” stream and a “Non-standard Applications” stream. Standard Applications will be fast-tracked with an aim that SFC authorisation (if granted) will be given around two to three months from the take-up date of the applications. Non-standard Applications will be also processed under an enhanced process with more discipline in response time.

The SFC will (i) take up or refuse to take up a new ILAS application within five business days upon receipt of the application; and (ii) issue the first set of response/requisitions to the new ILAS application within 14 business days from the take-up date.

A new ILAS application will generally lapse at the expiry of six months from the take-up date.

The SFC has also provided further guidance to ILAS issuers in section 1 of its FAQs on Investment-Linked Assurance Schemes to elaborate on the requirements under the Enhanced Process. The FAQs note that the Enhanced Process will generally apply to the processing of applications for authorisation of new investment options under existing SFC-authorized ILAS and that application for authorisation of a new investment option solely linked to an SFC-authorized fund will be treated as a Standard Application.

## **Effective date looms for new Code on Pooled Retirement Funds**

Su Cheen Chuah and Pauline Woo

On 19 November 2021, Hong Kong’s Securities and Futures Commission (**SFC**) published a gazette notice specifying that the effective date for the revised Code on Pooled Retirement Funds will be 1 December 2021.

The notice, together with a copy of the new code, which supersedes all previous versions, is available here: PRF Code

For further details of the new code and its effect on Pooled Retirement Funds (**PRFs**), see our previous publication.

Existing PRFs and those applying for the SFC’s authorisation before 1 December 2021, with key operators currently acting for SFC-authorized PRFs, will have (unless otherwise specified) a year’s transitional period from 1 December 2021 for compliance. In all other cases, the new PRF Code takes effect on 1 December 2021.

## **SFC brings first enforcement action against manager-in-charge**

Mary Nieto and Rakhi Punjabi

In early November 2021, the Hong Kong Securities and Futures Commission (**SFC**) announced that it had reprimanded and fined a licensed corporation (the **Firm**) HK\$3.3 million and suspended the licence of a member of its senior management for a period of six months, for internal control failures relating to the Firm’s placing activities and recording of client order instructions.

At the time of the Firm's breaches, the individual was the Firm's responsible officer (**RO**), and was also appointed as the director, deputy general manager, manager in charge (**MIC**) (Overall Management Oversight) and MIC (Key Business Line).

This marks the SFC's first enforcement action against an MIC since the MIC regime took effect in 2017.

### Individual misconduct

The SFC considered the Firm's failures were attributable to the individual's failure to discharge his duties as an RO and a member of the Firm's senior management.

Under section 193(2)(a) of the Securities and Futures Ordinance, where a licensed corporation is (or was) guilty of misconduct as a result of the commission of any conduct occurring with the consent or connivance of, or attributable to any neglect on the part of i) an RO of a licensed corporation or ii) a person involved in the management of the business of the licensed corporation, then that person is also guilty of misconduct. The SFC found that the individual was responsible for the management and supervision of the Firm's business operations in regulated activities at the material time.

The failures relating to placing activities involved breaches of the SFC's Placing Guidelines, the Code of Conduct, the Anti-Money Laundering and Counter-Terrorist Financing Ordinance and the SFC's AML Guideline. Failings related to the recording of client order instructions involved breaches of the SFC's Code of Conduct, Internal Control Guidelines and the Keeping of Records Rules.

The SFC's statement of disciplinary action is available here: [statement](#).

### Key reminders

The SFC will not hesitate to sanction both licensed corporations and those involved in the management of the business of the licensed corporation. It is worth noting that a 'person involved in the management of the business of the licensed corporation' includes both licensed and unlicensed individuals. In July 2021, the SFC sanctioned an unlicensed individual for failure to discharge his duties in relation to AML requirements as a member of a firm's senior management – see our article [here](#).

## Mainland China briefing: Newly launched Beijing Stock Exchange issues implementation rules for QFIs

Taylor Hui and Faye Meng

On 12 November 2021, the Beijing Stock Exchange (**BSE**) issued *Implementation Rules for Securities Trading by Qualified Foreign Institutional Investors and Renminbi Foreign Institutional Investors* (**Implementation Rules**, available [here](#) in Chinese), which took effect on 15 November 2021, the same day the BSE launched.

The creation of the BSE was announced in this September, with a purpose to focus on innovative small and medium-sized enterprises. Since then, the China Securities Regulatory Commission, the National Equities Exchange and Quotations (**NEEQ**, normally known as the new third board) and the BSE have issued a set of rules for BSE's operation, including the rules on listing, trading, and investor suitability management. The BSE is built on the basis of the existing select tier of NEEQ, which is the highest level tier of NEEQ.

Currently, among foreign investors, only Qualified Foreign Institutional Investors and Renminbi Foreign Institutional Investors (collectively, **QFIs**) are eligible to trade on the BSE. This is also consistent with the new rules governing the QFI regime issued in September 2020, which allow QFIs to invest in stocks listed on NEEQ.

The Implementation Rules set out general principles, regulatory requirements including requirements on information reporting/disclosure, trading rules and self-regulatory measures and disciplinary actions for QFIs trading on the BSE.

# Hong Kong SFC licensing and compliance hints

Connie Chan

## **New financial return form to be used soon**

The new financial return form will become effective on 1 January 2022 so licensed firms need to start collecting the newly required data if they have not done so yet. The new financial return requires additional pieces of information including breakdown of proprietary investments by product types, analysis of clients by geographical location and type, as well as AUM analysis by investment strategy and account type. Licensed firms will then need to submit the financial returns via the WINGS platform. A marked-up version of the new financial return form against the current one is available at this [link](#).

## **Are you familiar with the revised competency regime?**

The enhanced entry requirements for licence applicants and the ongoing competency standards for intermediaries and individual licensees will also come into effect on 1 January 2022. Licensed firms will need to assess the competence of individuals applying to be licensed with the SFC based on the new standards. In terms of CPT requirements, a minimum of 10 CPT hours and 12 CPT hours will be required for licensed representatives and Responsible Officers respectively. Ethics and compliance is also brought to the forefront with licensed individuals having to complete no less than two CPT hours on such topics per year. For a summary of the revised competency regime, please see our newsletter articles of [25 January 2021](#) and [24 June 2021](#).

## **The SFC issued new FAQs on reporting obligations under National Security Law**

The revised AML FAQs issued by the SFC on 22 October 2021 included the reporting of suspicious transaction reports under the National Security Law (NSL), as well as what is meant by "offence related property" under the NSL (see [Q20](#), [Q21](#) and [Q22](#)). Licensed firms need to disclose property held by any client whom they become aware has been arrested or charged for an offence endangering national security or when they have knowledge or suspicion that a property is "offence related property" (as defined under the NSL) to the Joint Financial Intelligence Unit "as soon as reasonably practicable", the FAQs say. The reporting framework under the NSL is similar to the framework under the Organized and Serious Crimes Ordinance.

## Recent publications

[Explanatory Note on "Regulated Activity" under the Insurance Ordinance](#)

[New tough law to combat "doxxing" comes into effect in Hong Kong](#)

[Getting prepared for Hong Kong's new conduct requirements for bookbuilding and placing activities which will take effect in August 2022](#)

[China's New Draft Guidance of Security Assessment for Outbound Data Transfers](#)

[Hong Kong Stock Exchange proposes rule amendments to enhance the regulation of share option / award schemes](#)

[Hong Kong's SFC concludes proposed amendments to Code on Pooled Retirement Funds](#)

[HKMA's Fintech Supervisory Sandbox links up with the PBOC's Fintech Innovation Regulatory Facility](#)

[Synthetic LIBOR available for certain currencies to facilitate wind-down of LIBOR](#)

[Information note on the end of LIBOR by the APLMA and the TMA](#)

[Recent update on Term SOFR and ARRC's best practice recommendations](#)

Board of the International Organisation of Securities Commissions (IOSCO) publishes final guidance report for artificial intelligence and machine learning

HKMA releases a technical whitepaper on Retail Central Bank Digital Currency (“CBDC”)

The Office of the Privacy Commissioner for Personal Data (“PCPD”) publishes FAQ on “Understanding the European Commission’s New Standard Contractual Clauses for Transfer of Personal Data from EU to Non-EU Regions”

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