DEACONS
的近律師行

Newsletter

Financial Services

21 June 2022

What's inside?

SFC proposes amendments to exemption for advertisements of investment products and enforcement-related provisions of the Securities and Futures Ordinance

Pinky Siu and Goofy Chan

On 10 June 2022, the Securities and Futures Commission (**SFC**) issued the Consultation Paper on Proposed Amendments to Enforcement-related Provisions of the Securities and Futures Ordinance (**Consultation Paper**). While the key amendments proposed in the Consultation Paper relate to enforcement and insider dealing provisions under the Securities and Futures Ordinance (Cap. 571) (**SFO**), the SFC also proposes to clarify the exemption in section 103 of the SFO relating to the issue of advertisements of investment products to professional investors (**PIs**).

Proposed amendments relating to advertisements of investment products

Section 103(1) of the SFO prohibits the issue of advertisements, invitations or documents relating to investment products unless the issue has been authorised by the SFC, subject to certain exemptions. In particular, section 103(3)(k) provides an exemption to section 103(1) for the issue, or the possession for the purposes of issue, of any advertisement, invitation or document made in respect of securities or structured products, or of interests in any collective investment scheme, that are or are intended to be disposed of only to PIs (**PI Exemption**).

In *Securities and Futures Commission v Pacific Sun Advisors Ltd and Mantel, Andrew Pieter*, in which the interpretation of the PI Exemption under section 103(3)(k) of the SFO was the subject matter of the appeal, the Court of Final Appeal (**CFA**) held that the PI Exemption applies to *any* advertisement having some connection or relation to investment products that are or are intended to be disposed of only to PIs. The effect of the CFA's interpretation is that, advertisements of investment products, albeit not authorised by the SFC, may nevertheless be issued publicly as long as the **products are intended for sale only to PIs**.

The SFC considers that the CFA's interpretation of the PI Exemption under section 103(3)(k) of the SFO may result in retail investors being exposed to unauthorised offers or solicitations to invest in risky or complex products which are unsuitable for them. The relatively lower threshold of qualifying for the PI Exemption (i.e. a mere intention to sell investment products only to PIs) makes the statutory regime extremely difficult, in the SFC's view, to enforce and it appears to contradict the intended purposes of Part IV and section 103(1) of the SFO, namely to regulate the *advertising* of (as distinct from the *sale* of) investments products which have not been authorised by the SFC.

The SFC therefore seeks to amend section 103(3)(k) of the SFO to the effect that the PI Exemption will only apply to **advertisements which are issued only to PIs**. As such, following the proposed amendments, unauthorised advertisements of investment products which are or are intended to be sold only to PIs may only be issued to PIs who have been identified as such in advance by an intermediary through its know-your-client and related procedures, regardless of whether or not such an intention has been stated on the advertisements.

In addition, the SFC also proposes to amend the exemption under section 103(3)(j) of the SFO (applicable to issue of advertisement, invitation or document to person outside Hong Kong) which is phrased in terms which are identical to the PI Exemption to reflect the same amendments made to section 103(3)(k) of the SFO for consistency.

While the SFC has not yet set out the exact manner in which sections 103(3)(j) and 103(3)(k) of the SFO are to be amended in the Consultation Paper, the proposal may trigger a need for fund managers to review the existing practice in issuing or distributing advertisements relating to investment products which are only intended for sale to PIs. As indicated in the Consultation Paper, the SFC will expect advertisements relating to products for sale or intended for sale to PIs to be issued to a particular group of prospective investors which have been identified to be qualified as such **in advance** through know-your-client and related procedures. Enhanced measures in controlling the audience to which such advertisements are made available may be required.

Proposed amendments to the SFC's power to apply for court orders

The Consultation Paper also covers proposed amendments to section 213 of the SFO, which empowers the SFC to apply to the Court of First Instance (**CFI**) for various orders (**Section 213 Orders**) to provide remedies for persons affected by contraventions by another person of certain provisions under the SFO or requirements or conditions imposed by the SFC. Such Section 213 Orders may include, for example, an order restraining or prohibiting a breach of the relevant provisions, an order requiring a person to take steps to restore the parties to any transaction to the position in which they were before the transaction was entered into, and an order requiring a person to pay damages to any other person.

Under the current regime, the SFC has no power to apply for Section 213 Orders from the CFI when a regulated person has been found guilty of misconduct or not to be fit and proper to remain a regulated person under sections 194 or 196 of the SFO unless the conduct also constituted a contravention of one of the relevant provisions, requirements or conditions described above (which would not cover circumstances where there is a breach of the SFC's codes and guidelines by a regulated person, however serious the nature of such breach is). The SFC also has no statutory powers at present to directly require the regulated person to take any steps to restore, compensate or otherwise protect the interests of investors or clients who may have been adversely affected by the regulated person's conduct.

It is now proposed to allow the SFC to apply for Section 213 Orders where the SFC has exercised any of its powers under sections 194(1), 194(2), 196(1) or 196(2) of the SFO (collectively, the **Relevant Provisions**) against a regulated person. Consequentially, the SFC also proposes to amend section 213(3A) of the SFO to enable the SFC to apply for Section 213 Orders where it has exercised any of its powers under the Relevant Provisions against a regulated person who is a director, investment manager, custodian or a sub-custodian of an open-ended fund company (**OFC**). Key operators of an OFC should take note of the expanded scope of the SFC's enforcement powers, should the proposed amendments to section 213 of the SFO materialise.

SFC is currently inviting the public to submit comments no later than 12 August 2022 on the proposed amendments set out in the Consultation Paper.

DEACONS
的近律師行

MPF investments broadened to include Chinese government bonds

Ming Chiu Li

Hong Kong's Mandatory Provident Fund Schemes (General) Regulation (Cap. 485A) has been amended to facilitate the investment of MPF funds into debt securities issued or unconditionally guaranteed by the Central People's Government, the People's Bank of China, the Agricultural Development Bank of China, the China Development Bank and The Export-Import Bank of China. Pursuant to the amendments, these entities will be added to the category of "exempt authority". An MPF constituent fund may invest up to 30% of its funds in debt securities of the same issue issued or unconditionally guaranteed by an exempt authority. All of the funds of the MPF constituent fund could also be invested in debt securities comprising at least six different issues issued or unconditionally guaranteed by the same exempt authority.

As the MPFA continues to review permissible classes of assets, this legislative amendment is seen to further diversify the types of investments that may be held by MPF funds.

In recent years, we have seen MPF product providers diversify their range of products to cover "onshore" China assets, as the connectivity between the Mainland and the Hong Kong markets continues to develop. In 2020, the Shanghai Stock Exchange and the Shenzhen Stock Exchange were added to the list of approved stock exchanges for the purpose of investment in equity securities. In respect of debt securities, some trustees have already offered constituents funds that provide exposure to bonds traded on the China interbank bond market through the Bond Connect. MPF investments in bonds are subject to relevant requirements prescribed in the Mandatory Provident Fund Schemes (General) Regulation, applicable to the issuers or the credit ratings of the bonds.

We foresee that product providers will review their existing range of products and launch new funds to benefit from the legislative amendments. These new changes are expected to improve the investment choice for delivering retirement solutions to MPF scheme members, who can choose to diversify their holdings into the relevant assets, in order to achieve their intended overall asset allocation.

Expanding market access between Mainland China and Hong Kong

Alwyn Li and George Ho

On 25 May 2022, Mr. Ashley Alder, CEO of Hong Kong's Securities and Futures Commission (**SFC**) delivered a speech at the annual China Capital Markets Conference hosted by the Asia Securities Industry and Financial Markets Association.

Mr. Alder noted in his speech that the SFC is keen to expand the Mainland-Hong Kong Mutual Recognition of Funds (**MRF**) framework by relaxing restrictions on the value of fund flows from the host market as well as the existing limits on fund management delegation. To this end, there has been industry lobbying and market rumours on the potential relaxation on delegation, minimum fund size and the current 50% NAV threshold for the units sold to Mainland investors. Another potential addition would be for Hong Kong domiciled Open-ended Fund Companies (**OFCs**) to be recognised under the MRF framework.

However, the expansion of the MRF framework is not intended to replace the Wealth Management Connect initiative (**WMC**) since the two schemes have different regulatory requirements. For instance, WMC may be considered a simpler route for asset managers to target Mainland investors as there is no need for participating Hong Kong funds to obtain approval from the Chinese securities regulator, but at present, it is limited geographically to the Greater Bay Area. In contrast, MRF is available across Mainland China. Therefore, we expect both initiatives will provide more opportunities in the future as they continue to develop.

Mr. Alder's speech also touched on the implementation of the connect scheme for trading of exchange-traded funds between Mainland China and Hong Kong (**ETF Connect**). ETF Connect aims to provide a quick and cost-efficient way for ETF managers to make their funds available on a cross-border basis under Stock Connect. Participating ETFs will not be subject to product-by-product approval by the host regulator, though they will need to meet eligibility requirements around factors such as fund size, turnover and whether an underlying index mainly tracks stocks eligible for trading under Stock Connect. At the outset, it appears that the number of eligible ETFs listed in the Mainland will be much larger than that in Hong Kong, which indicates that there is room for the ETF market to grow in Hong Kong.

ETF Connect will follow a "pilot" approach and will aim to "test the waters" as other schemes have done. Mr. Alder urged asset managers to remain patient as it is anticipated that eligibility requirements will be relaxed in due course as the initiative gains traction.

For details of the ETF Connect initiative, please refer to our Client Alert, "ETF Connect: Implementation details announced", which is available here.

Distributing NFTs – Hong Kong regulatory issues

Su Cheen Chuah and Mary Nieto

Hong Kong's Securities and Futures Commission (**SFC**) recently issued a warning to investors about the risks associated with non-fungible tokens (**NFTs**).

In addition to reminding investors about the various risks involved in investing in NFTs and other virtual assets, the SFC also reminded market participants that NFTs may, depending on their structure, constitute "securities" or interests in a "collective investment scheme" (**CIS**), both as defined in the Securities and Futures Ordinance (**SFO**).

When marketing or distributing an NFT in Hong Kong, the two main issues that need to be considered from a securities regulatory perspective are:

1. Licensing: Marketing or distributing an NFT that constitutes "securities" in Hong Kong may be considered a "regulated activity" under the SFO. It is a criminal offence under the SFO to carry on a business in any regulated activity in Hong Kong without the proper SFC licence unless an exemption is available.

2. Offering rules: Subject to the exemptions set out in the SFO and other legislation, it is an offence to offer to the Hong Kong public an interest in a CIS which is not authorised by the SFC. The SFC says "where an arrangement in relation to an NFT involves any offer to the Hong Kong public to participate in a CIS, authorisation requirements under the SFO may be triggered".

Further information

The SFC has established a dedicated area of its website to provide information for businesses which intend to conduct regulated activities involving virtual assets: SFC Fintech Contact Point

For a summary of the joint circular issued by the SFC and the Hong Kong Monetary Authority on 28 January 2022 on the distribution of virtual asset-related products, the provision of virtual asset dealing services and the provision of virtual asset advisory services, please see: Changes to the requirements for virtual asset-related activities

For a brief overview of other legal issues, such as intellectual property rights, in relation to NFTs, please see: Trading NFTs? A few legal reminders

Mainland China briefing: AMAC issues checklists and key points to note for private fund managers

Fiona Fong and Faye Meng

On 2 June 2022, the Asset Management Association of China (**AMAC**) published a notice on matters relating to the registration and filing obligations of Chinese private fund managers (**Notice**, available here in Chinese). Together with the Notice, AMAC issued (i) revised checklists for the registration application of private fund managers and (ii) key points to

DEACONS
的近律師行

note for filing of private funds in Mainland China. AMAC issued separate checklists and key points for (i) private securities fund houses and (ii) private equity and venture capitalist firms.

The revised checklists require information over nine areas including (i) basic information about the applicant, (ii) relevant mechanisms such as risk management, information disclosure and transaction records, (iii) licensing details of the applicant and information of affiliates, (iv) integrity information, (v) financial statements, (vi) information about funders, (vii) information about the largest shareholder and actual controlling person, (vii) information about senior management and (viii) a legal opinion. The revised checklists aim to improve the transparency of the AMAC application process and facilitate the preparation of application materials by private fund managers.

It is worth noting that, among other key points, AMAC specifically reminds managers of the naming rules for private funds. Similar requirements are in fact set out in the Private Investment Funds Naming Guidelines (available in Chinese here) issued by AMAC back in 2018. For private hedge funds:

1) the name of the fund should not include:

- misleading terms such as “safe”, “risk-aversion”, “principal-guaranteed”, and “sure-win”;
- terms inconsistent with the fund’s risk profile such as “high return” and “no risk”;
- terms exaggerating the performance of the fund such as “the best performance”, “the largest” and “leader”;
- terms that are easily confused with asset management products issued by financial institutions such as “asset management plan”, “trust plan”, “separately managed account”, “wealth management products”, etc.; or
- the names of well-known persons, well-known institutions or trade names (except with lawful authorisation);

2) the managers shall pay attention to:

- whether the name of the fund includes terms such as “equity investment”, “mixed investment”, and “fixed income investment” which supposedly reflect the specific investment area of the fund;
- whether the name of the fund includes the full name of the manager or an abbreviation that clearly represents the manager’s name;
- if the fund is a classification fund, whether the term “classified” or “structured” is included in the fund name; and

3) the managers shall also pay attention to whether the fund name contains words that violate laws, administrative regulations or relevant regulations of the China Securities Regulatory Commission, and whether it contains words that violate public order and good morals.

In Hong Kong, for an open-ended fund company (**OFC**), its name and any subsequent change to the name is subject to the review and approval by the Securities and Futures Commission (**SFC**). The Code on Open-Ended Fund Companies (**OFC Code**) provides, inter alia, that the name of an OFC must in the opinion of the SFC not be misleading or otherwise undesirable. The SFC may take into account whether the proposed name is inconsistent with the nature, investment objectives or policy of the OFC; whether it is substantially similar to the name of another OFC; whether it would give investors a sense of assurance or security not justified by the underlying features of the OFC; and whether it might lead investors into inferring or might otherwise create the impression that persons other than the directors and/or investment manager are responsible for the OFC. In our experience, the SFC will review the name of an OFC as well as the name of its sub-fund(s) in the case where the OFC is an umbrella fund, and by reference to relevant rules of the OFC Code, the SFC may require an explanation of the proposed name from the applicant in the process of incorporating an OFC.

Hong Kong SFC licensing and compliance hints – June 2022

Lavita Pong

Client onboarding CDD

Onboarding customers during fund launches often involves significant time pressure as licensed corporations (**LCs**) tend to prefer to collect all the required customer due diligence (**CDD**) documentation before fund close, rather than relying on the time extension (of up to 120 days) for obtaining all CDD documentation as permitted under the SFC AML Guideline, subject to fulfilling certain conditions.

We have set out some hints concerning the common pitfalls and how to navigate them when undertaking the onboarding process.

1. High risk country lists

Risk assessment of customers involves several factors including the country risk factor. The SFC has recently pointed out during its Anti-Money Laundering and Counter-Financing of Terrorism Webinar 2021 that some LCs failed to ensure that their high-risk country lists are complete and up-to-date relating to the proper classification of money laundering and terrorist financing risks of customers.

Taking the high-risk country lists issued by the Financial Action Task Force (**FATF**) as an example, the FATF does not have a definitive timetable as to when it updates the lists, therefore LCs should, as part of their compliance monitoring action plan, designate a staff member to conduct a monthly check to ensure that these lists are complete and up-to-date. The following lists are available by clicking "Publications" and clicking "High-risk and other monitored jurisdictions":

- Jurisdictions under Increased Monitoring
- High-Risk Jurisdictions subject to a Call for Action

2. HK Company searches

Although it may be convenient to request a corporate investor to provide a full company search report or alternatively a long list of certified copies of required CDD documentation including a certificate of incorporation, a certificate of incumbency and a certificate of good standing, LCs can adopt alternative measures if they prefer not to request the documentation from their investors.

Taking a Hong Kong incorporated company as an example, LCs can undertake online company searches at the Companies Registry in order to verify the name, legal form, current existence and powers that regulate and bind the investor (4.2.6 and paragraph 3 of Appendix C of the SFC AML Guideline) and all of these can be verified online free of charge if the compliance department of the LC is prepared to work with screenshots instead of print / certified copies (see the following section re hints relating to electronic documents). However, LCs will still need to pay certain fees in order to obtain specific documents such as the latest annual return in order to ascertain the shareholder and director information.

3. Electronic documents

After conducting a Hong Kong Companies Registry search as described above, if an LC is undertaking the search itself, it is fine to rely on the downloaded document from the Companies Registry because it is a reliable source, instead of requiring a certified copy (see Anti-Money Laundering and Counter-Financing of Terrorism FAQ #9 updated as of 22 October 2021). Although this FAQ does not mention screenshots obtained after logging into the Hong Kong Companies Registry's Cyber Search Centre, an LC's compliance department can take a risk-based approach and consider accepting screenshots obtained by the LC itself.

Six months remaining for your 2022 CPT hours

If you are licensed by the SFC as a licensed representative or responsible officer you must ensure you obtain your required CPT hours by the end of the year as outlined below.

Topics	**Licensed representative**	**Responsible officer**
Directly relevant to your regulated activity	5	5
Ethics or compliance	2	2
Regulatory compliance	0	2
Other relevant topics	3	3
Total CPT hours per calendar year:	10	12

Please take note of other specific requirements if you are engaging in work related to sponsors or takeovers (5.3(a) and 5.3(b) of the Guidelines on Continuous Professional Training of January 2022). You can also refer to our previous article of 25 February 2022 for further details.

Webinar invitation

Following the trend – learn more about private OFC in one hour
顺势而为 – 1 小时了解香港开放式基金公司（私人 OFC）基础

Date: Thursday, 30 June 2022
Time: 16:30 -17:30 HKT
Venue: Online
Language: Mandarin

In this webinar, the speakers will share their insights on Hong Kong's open-ended fund company (**OFC**) structure. They will look at issues from the manager's perspective, and will cover legal, regulatory and operational requirements, including the government grant scheme and custody arrangements.

Moderator:
Fiona Fong, Partner, Deacons

Speakers:
Anastasia Bian, Sales Representative, Interactive Brokers Hong Kong Limited
Erin Wu, SVP, Head of Investor Relations, OP Investment Management
Fiona Tse, Associate Director, Investment Products, Securities and Futures Commission

For registration, please visit OP Investment Management's event web page at https://opim.ac-page.com/20220630-opim-deacons.

Recent publications

Hong Kong passes two important employment-related bills within one week

Hong Kong is making headway in having the widest reciprocal enforcement arrangement with the Mainland

Further development in Hong Kong-Mainland cross border insolvency

Court orders insider dealers to pay HK$12.9 million to 63 investors in civil proceedings commenced by the SFC under s.213 of SFO

Key takeaways on the Rental Moratorium under the Temporary Protection Measures for Business Tenants (COVID-19 Pandemic) Ordinance

Is the metaverse above the law?

Revamped ICSID Rules for arbitration and conciliation of investment disputes

Arbitral award set aside for going beyond the scope of pleadings

Court upholds arbitration clause in deed of mutual covenant

[Court refuses enforcement of Mainland arbitral award]

[ETF Connect: Implementation details announced]

Want to know more?

Jeremy Lam
Partner
jeremy.lam@deacons.com
+852 2825 9732

Taylor Hui
Partner
taylor.hui@deacons.com
+852 2826 5368

Alwyn Li
Partner
alwyn.li@deacons.com
+852 2825 9627

Su Cheen Chuah
Partner
sucheen.chuah@deacons.com
+852 2825 9651

Fiona Fong
Partner
fiona.fong@deacons.com
+852 2826 5316

Ming Chiu Li
Partner
mingchiu.li@deacons.com
+852 2825 9752

Pinky Siu
Partner
pinky.siu@deacons.com
+852 2825 9568

Joyce Li
Partner
joyce.li@deacons.com
+852 2825 9318

Scott Carnachan
Consultant
scott.carnachan@deacons.com
+852 2825 9265