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Firms get ready for SFDR Level 2 compliance – 1 January 2023 deadline approaching

Alwyn Li and Vincci Ip

On 1 January 2023, the Level 2 requirements under the Regulatory Technical Standards (**RTS**) for the EU Sustainable Finance Disclosure Regulation (**SFDR**) and the Taxonomy Regulation, generally known as “SFDR Level 2”, will come into effect. From that date, financial market participants such as asset managers and management companies of financial products such as UCITS will need to comply with the SFDR Level 2 requirements. The requirements under the RTS cover four main areas:

- Template pre-contractual disclosures for financial products falling under Article 8 and Article 9 of SFDR;
- Website disclosures for Article 8 and Article 9 financial products;
- Template principle adverse sustainability impacts statement; and
- Template periodic disclosures for Article 8 and Article 9 financial products.

For the purpose of this article, we will look at the pre-contractual disclosure requirements for SFDR Article 8 and Article 9 funds and the relevant regulatory requirements in Hong Kong.

The RTS sets out detailed requirements for pre-contractual disclosures for Article 8 and Article 9 funds. In order to allow for consistency in reporting across funds and to ensure that investors have comparable information to make informed investment decisions, pre-contractual disclosures must be made using the mandatory templates that are set out in the annexes to the RTS for the relevant financial product. The mandatory templates are in Q&A format and the information will need to be attached as an annex to the pre-contractual documentation, e.g. prospectuses.

With less than three months to comply with the SFDR Level 2 requirements, we note that many UCITS are updating their prospectuses to comply with the pre-contractual disclosure requirements. For retail UCITS authorised by the Securities and Futures Commission of Hong Kong (**SFC**), management companies should also ensure that the relevant SFC post-authorisation requirements (including any regulatory approval and investor notice requirements) are complied with in respect of the changes to the prospectuses. In general, if the relevant changes are considered to be non-material changes, SFC prior approval would not be required. However, the management companies will need to confirm:

- the changes do not amount to a material change to the fund;

- there will be no material change or increase in the overall risk profile of the fund following the changes; and
- the changes do not have a material adverse impact on holders' rights or interests (including changes that may limit holders' ability in exercising their rights).

Additional requirements (including disclosure requirements) will need to be observed if the authorised UCITS is marketed as an ESG fund in Hong Kong, i.e. a fund which incorporates environmental, social and governance (**ESG**) factors as its key investment focus and reflects the same in its investment objective and/or strategy.

Following the regulatory clarification of the SFDR by the European Commission that a fund with a sustainable investment as an objective should only make sustainable investments, some SFC-authorised UCITS which invest in non-sustainable investments will no longer satisfy the requirements of SFDR Article 9 and the classification of such UCITS may need to change from Article 9 to Article 8 under the SFDR. Management companies of these UCITS will need to consider the implication of the re-classification, the actual changes involved (e.g. any change to the investment objective, investment policy and/or risk profile of the fund), the nature of changes (e.g. material or non-material changes or purely clarification or enhancement of disclosures) and comply with the relevant SFC requirements (including any regulatory approval and investor notice requirements).

Mainland China briefing – October 2022

Taylor Hui and Faye Meng

CSRC to loosen short swing profit rule for foreign public funds

The China Securities Regulatory Commission (**CSRC**) is working on policies on the application of certain short swing profit rules for foreign investors, in order to facilitate foreign investors' participation in the A-Shares market.

The so called "short swing profit rule" is specified under the current Securities Law of China, which states that where any shareholder holding 5% or more of shares of a company listed in Mainland China sells securities of that company within six months after the purchase thereof, or purchases securities within six months after sale, the profits generated from such short-term trading shall be returned to the listed company. The Securities Law also stipulates that the CSRC has the power to prescribe exemptions to the short swing profit rule. A foreign fund manager is currently required to aggregate all its funds' holdings in a listed company.

According to a news report by Shanghai Securities News on 16 October 2022, the newly proposed policies include (i) allowing eligible foreign public funds to calculate the shareholding on each product level for the purpose of determining short-term trading, with reference to domestic public funds; and (ii) exempting Hong Kong Securities Clearing Company Limited from the application of certain short swing profit rules, in respect of transactions conducted under the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect regimes.

In practice, the CSRC has allowed domestic public fund houses and China's National Social Security Fund to calculate the shareholding by product, instead of aggregating the shareholding at the fund manager level. The proposed policies will benefit foreign fund managers by allowing them to enjoy equal treatment.

The report states that the CSRC has already drafted the new measures and is fulfilling relevant procedures for publication. We will monitor progress and share updates in the future.

Disciplinary action highlights the responsibilities of a compliance MIC and the reporting duty of a licensed corporation

Rebecca Yip and Victoria Ka

The Securities and Futures Commission (**SFC**) has recently reprimanded and fined a licensed corporation (the **LC**) HK\$1.75 million and also its former Head of Compliance and Operations and Manager-in-Charge of Compliance (the **MIC**) for two months. This case is significant as it highlights SFC's application of various provisions under the Code of Conduct for Persons Licensed by or Registered with the SFC (**Code of Conduct**).

Summary of facts

1. The LC is licensed under the Securities and Futures Ordinance to carry on type 9 (asset management) regulated activity.
2. The Financial Conduct Authority in the United Kingdom (**FCA**) found that the LC had breached the European Union's short selling regulation (**EU Regulation**) for failing to make notifications to the FCA and public disclosures of its net short position a London Stock Exchange-listed company (the **Listed Company**), and was fined £873,118.
3. The SFC conducted an investigation against the LC as a result of the FCA's enforcement action.

The LC's compliance failures and internal control deficiencies

The SFC found the LC had breached the Code of Conduct by failing to:

1. implement adequate measures to ensure compliance with the EU Regulation;
2. seek legal advice on its reporting obligations under the EU Regulation before entering into swap transactions and establishing a short position in the Listed Company even though it was unfamiliar with the EU market; and
3. report to the SFC immediately upon becoming aware it had materially breached the EU Regulation, in breach of paragraph 12.5 of the Code of Conduct.

The MIC's compliance failures

The SFC found that the LC's failures were attributable to the MIC's neglect in discharging his responsibilities as the LC's Manager-in-Charge of Compliance and a member of its senior management. In particular, Wong failed to:

1. implement adequate systems and controls to ensure the LC's compliance with the EU Regulation; and
2. seek legal advice on the reporting obligations for the LC's short position in the Listed Company.

Key reminders to licensed intermediaries and MICs

This disciplinary action is significant and serves as a reminder to licensed corporations and MICs of the following:

1. the SFC can take disciplinary action against a licensed corporation for failing to comply with regulatory requirements in a foreign jurisdiction;
2. a licensed corporation is required to seek legal advice on licensing or regulatory requirements before venturing into any new jurisdictions or new products, and on any matters which it is not familiar with, in order to ensure its compliance with the latest and the relevant regulatory requirements;
3. report to the SFC immediately upon the occurrence of a material breach, infringement, or non-compliance with the requirements of any regulatory authority (including any foreign regulatory authority as demonstrated by this case) or when it suspects such breach, infringement or non-compliance; and
4. MICs and members of senior management of a licensed corporation need to assume the duties and bear the responsibilities for ensuring their licensed corporation maintains the appropriate standards of conduct and adherence to proper procedures. They also need to properly manage the risks associated with the licensed corporation's business.

Hong Kong SFC licensing and compliance hints – October 2022

Lilian Lai

More information required for temporary representative licence applications

In light of the new '0+3' quarantine arrangement, more licensed corporations are reviving their plans to have personnel

from their overseas regulated group companies travel to Hong Kong. Recently, we have seen more temporary representative licences being applied for by such overseas individuals to enable them to conduct regulated activities in Hong Kong for a short period of time (not more than three months at one time).

For those who have previously applied for a temporary representative licence and wish to re-apply for one now, the relevant eligibility requirements have not changed. However, you will now have to provide more information in the relevant SFC application form on WINGS than in the previous paper form. For example, you now need to provide details of the activity that you carry on overseas, which, if carried on in Hong Kong, would constitute the carrying on of a regulated activity. You will also need to address any possible conflicts between your role with the overseas group company for which you act (or any other employment you might have) and your proposed role as a temporary representative in Hong Kong.

Applicants should also allow sufficient time for the SFC to process their temporary representative licence applications, to ensure that they obtain SFC approval prior to the date on which they intend to commence carrying on any regulated activity in Hong Kong.

Hotel as residential address

For individual licence applicants who anticipate being stationed in Hong Kong once licensed, you will need to provide the SFC with a permanent Hong Kong residential address as part of the application. If the residential address provided to the SFC in the application is a hotel address, it is likely that the SFC will ask for updates concerning progress in finding a permanent residence, and you will need to provide such address to the SFC once it becomes your residence. Any subsequent change in your residential address will need to be notified to the SFC within seven business days of the change.

Recent publications

[Hong Kong bourse proposes to create a new channel to listing for "Specialist Technology Companies"](#)

[The word on the street: the risk of using slang in advertising](#)

[White House releases First-Ever Comprehensive Framework for Responsible Development of Digital Assets](#)

[HKMA releases a position paper on e-HKD](#)

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