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## Recent regulatory developments in virtual asset products

Su Cheen Chuah and Mary Nieto

The Hong Kong Government has recently issued a policy statement on the development of virtual assets (**VA**). It outlines the Government's approach "towards developing a vibrant sector and ecosystem" for VA in Hong Kong. On 31 October 2022, Julia Leung, the SFC's Deputy CEO, issued a [keynote address](#) on the regulation of the crypto community at the Hong Kong FinTech Week 2022.

In this article we highlight a few key initiatives in the regulation of VA.

### Licensing of VA service providers

The Government plans to implement a licensing regime for virtual asset service providers (**VASP**). A bill was gazetted in June 2022 and is currently under the legislative review process. As the Government points out in its policy statement, "financial intermediaries and banks will be able to partner with licensed VA exchanges when offering clients with VA dealing services, provided that relevant regulatory conditions are met". One of the licensing conditions is that services should be limited to professional investors. For further details, please see our previous publication [Final shape of the licensing regime for virtual asset service providers](#).

### Retail access to VA products

#### *Relaxation of professional investor requirement*

The Government's policy statement announced that the Securities and Futures Commission (**SFC**) will be conducting a public consultation on how retail investors may be given a suitable degree of access to VA under the new licensing regime. Ms Leung addressed this in her speech, "the SFC is minded to consult the public on whether the professional-investor-only requirement could be relaxed; and if so, what should be the governance procedures and listing criteria for the VASP to admit tokens for secondary market trading by retail investors". The SFC is undergoing a soft consultation of the industry and stakeholders and will issue its public consultation in due course.

#### *VA futures ETFs*

Ms Leung announced in her speech that the SFC "has been actively looking to set up a regime to authorise ETFs which provide exposure to mainstream virtual assets with appropriate investor guardrails", and that the SFC would later that day issue a circular on the authorisation of VA futures ETFs for public offering in Hong Kong. She said "Apart from the existing requirements for ETFs, virtual asset futures ETFs will also be subject to additional requirements related to its management company, investment strategy, disclosure and investor education."

These additional requirements include the following:

- the management company of a VA futures ETF is required to (i) have a good track record of regulatory compliance; and (ii) demonstrate at least three years' proven track record in managing ETFs;
- initially, only Bitcoin futures and Ether futures traded on the Chicago Mercantile Exchange are allowed;
- a VA futures ETF is expected to adopt an active investment strategy; and
- the net derivative exposure (as defined under the Code on Unit Trusts and Mutual Funds) of a VA futures ETF shall not exceed 100% of the ETF's total net asset value.

Further details are set out in the circular on "[Virtual Asset Futures Exchange Traded Funds](#)".

Market commentators have noted that the SFC is adopting a more permissive stance with regards to retail access to VA products as compared with Singapore's MAS.

## Regulatory updates on SFC-authorised funds

Alwyn Li, Eve Leung and Kent Ng

On 11 November 2022, Hong Kong's Securities and Futures Commission (**SFC**) published various updated documents in respect of the following changes to their requirements applicable to authorised funds.

### **(A) Streamlined approach applicable to certain changes of investment delegate**

Pursuant to 11.1(b) of the Code on Unit Trusts and Mutual Funds, changes of investment delegates of SFC-authorised funds and their regulatory status must be submitted to the SFC for prior approval.

With effect from 11 November 2022, the SFC has adopted a streamlined approach, under which the SFC's prior approval will no longer be required in respect of the following changes of investment delegates:

- (i) replacement of an existing investment delegate or appointment of a new investment delegate if the new investment delegate is currently managing other existing SFC-authorised fund(s), and belongs to the same corporate group as the management company or (in the case of delegation by the immediate delegate of the management company to the new sub-investment delegate) the immediate delegate of the management company; and
- (ii) removal of an investment delegate if the management company confirms that the compliance confirmations and/or undertakings previously provided to the SFC remain valid, and the investment delegate to be removed was not appointed and delegated at all times with the investment management functions subject to the authorisation conditions imposed by the SFC.

The above streamlined arrangements, however, do not apply to changes of investment delegates which will involve new proposed all-time investment management delegation or result in a change to any all-time investment delegation arrangement currently adopted by the relevant SFC-authorised fund.

### *Notice*

It is generally expected that one month's prior written notice should be provided to Hong Kong investors of these changes and the notice should meet the content requirements set out in FAQ 16A – 16D of "Frequently Asked Questions on Post-Authorisation Compliance Issues of SFC-authorised Unit Trusts and Mutual Funds".

### *Revised offering documents*

No further SFC approval of the revised offering documents of the SFC-authorised fund is required to the extent it solely reflects the changes of investment delegates pursuant to the above streamlined approach.

## Filing forms

The relevant filing forms have been updated by the SFC to facilitate the streamlined approach. For replacement of an existing investment delegate or appointment of a new investment delegate as mentioned in (i) above, the management company is required to provide the same confirmations and undertakings in respect of change of investment delegates as set out in the "List of Confirmations of Compliance related to Application for Approval of Scheme Change(s) pursuant to 11.1 of the Code of Unit Trusts and Mutual Funds".

In light of the new streamlined approach, the SFC has updated the following documents to provide further guidance on changes of investment delegate that do not require the SFC's prior approval:

- a) Frequently Asked Questions on Post-Authorisation Compliance Issues of SFC-authorized Unit Trusts and Mutual Funds – FAQs 11A and 12A
- b) Filing Form for Notice of Scheme Change(s) falling within 11.B of the Code on Unit Trusts and Mutual Funds and Do Not Require SFC's Prior Approval
- c) Filing Form for Revised Offering Documents that Incorporate Changes Falling within 11.1B of the Code on Unit Trusts and Mutual Funds (UT Code) and Do Not Required SFC's Prior Approval

### **(B) Other regulatory updates**

The SFC has also introduced the following updates:

- streamlined disclosure requirements relating to PRC legal opinions on the custody arrangement for funds investing 70% or more of their net asset value in onshore PRC securities via the Qualified Investors (QI) / China Interbank Bond Market (CIBM) regime;
- revised FAQs 14 and 15 of the Frequently Asked Questions on the Implementation and Transition Arrangements of the Code on Unit Trusts and Mutual Funds (Effective on 1 January 2019) to clarify that the SFC's prior consultation will be required if an SFC-authorized fund intends to invest primarily in debt instruments with loss-absorption features.
- on 15 November 2022, revised Circular on Mutual Recognition of Funds (MRF) between Thailand and Hong Kong to expand the eligible types of Thai funds applying for the SFC's authorisation to include (i) listed real estate investment trusts; (ii) listed property funds; (iii) listed infrastructure funds, or some combination thereof.

## Exemption of annual report requirements for OFCs

Fiona Fong and Thean Chiap Khoo

The Securities and Futures Commission (**SFC**) recently clarified exemptions for open-ended fund companies (**OFCs**) from the requirement to prepare and publish annual reports.

Under the Securities and Futures (Open-Ended Fund Companies) Rules (**OFC Rules**), OFCs are required to prepare an annual report for each financial year, containing financial statements and an auditor's report. An OFC must also publish the annual report and provide, on request, a copy of the report free of charge to shareholders.

A financial year usually covers an accounting reference period of 12 months. The first financial year of an OFC begins on the date of its incorporation and ends on its primary accounting reference date. Such date is commonly referred to as the financial year-end, which can be specified by the OFC's board of directors typically as 31 December or the last day of other calendar quarters, or in the absence of a specified date, the last day of the month in which the first anniversary of the OFC's date of incorporation falls. If an OFC is not launched after it is incorporated, unless otherwise exempted, it remains a mandatory requirement to prepare an annual report.

The abovementioned requirements may, on application by an OFC, be exempted by the SFC in certain circumstances. On 1 November 2022, the SFC updated its Frequently Asked Questions relating to Open-ended Fund Companies (FAQ) and provided guidance and clarification on exemptions from the requirement to prepare and publish annual reports (**AR**

**Exemption).** While it is up to the SFC to determine whether certain circumstances are appropriate for granting an AR Exemption, it is generally expected that for an application seeking an AR exemption, the following conditions should be met:

- i. the relevant OFC or sub-fund(s) has not been launched; and
- ii. the relevant OFC or sub-fund(s) has no investor, (collectively the **Conditions**).

An OFC or its sub-fund is generally considered not to have been launched if no subscription proceeds for participating shares (excluding management shares) have been received.

In making an application to the SFC, the directors of an OFC should provide a certification that the Conditions are fulfilled and any other supporting documents that SFC may request.

In addition, if an OFC is formed as an umbrella OFC, the SFC's Code on Open-Ended Fund Companies (**OFC Code**) provides that the financial reports shall show the respective financial positions and results of such umbrella OFC (and its sub-funds). An umbrella OFC that fulfils the Conditions may apply for a waiver (in addition to the AR Exemption) in respect of this requirement (**Code Waiver**).

Notwithstanding the grant of an AR Exemption and, where appropriate, a Code Waiver by the SFC, OFCs and their directors should take note of the following:

- i. the financial statements of such OFC should mention the names of the sub-funds which have not been launched and for which an AR Exemption and/or a Code Waiver have been granted;
- ii. the AR Exemption and/or Code Waiver will lapse when the relevant OFC or sub-funds no longer meet the Conditions; in which case, the OFC must notify the SFC in writing immediately;
- iii. the OFC and its directors should continue to comply with the applicable provisions in the OFC Rules and OFC Code, including the obligation to maintain proper books and records of the OFC and its sub-funds; and
- iv. after an OFC or sub-fund has been launched, its first annual report should cover the period commencing from the incorporation of the OFC or establishment of the sub-fund(s) (as the case may be) to the end of the relevant financial year.

The updated FAQ is a response by the SFC to requests for clarification of the annual report requirements, particularly in respect of OFCs experiencing some delay in the fund launch. As a matter of practice, if an OFC wishes to apply for AR Exemption and/or Code Waiver, the SFC encourages the board of directors of the OFC to consult the relevant SFC case officer in advance.

## Hong Kong SFC licensing and compliance hints – November 2022

Connie Chan

### **Can I be exempted from re-taking HKSI licensing exams if I was previously licensed with the SFC between three to eight years ago?**

An exemption from re-taking the HKSI licensing exams is available for individuals seeking to re-enter the industry, provided the following conditions can be met: (i) they were last licensed with the SFC between three to eight years ago; and (ii) they are re-applying for a licence with the same competency requirements and in the same role as when they were previously licensed. In such circumstances an individual may apply for a conditional exemption from the regulatory framework paper requirements (e.g. HKSI licensing exam paper 1) in reliance upon the re-entrant exemption under section of 4.4.4 of the Guidelines on Competence. To be eligible for the exemption, an individual needs to complete five CPT hours per regulated activity applied for, per year of absence (any fraction of a year needs to be rounded up). Training in local regulatory knowledge needs to make up at least 50% of the CPT activities before the submission of the application. Furthermore, a

confirmation of the completion of the required CPT hours needs to be provided to the SFC, and supporting records which evidence the completion of the required CPT hours need to be kept.

As an example, if you were licensed with the SFC four years ago and now want to apply to be a representative for types 1, 4 and 9 regulated activities, you would need to complete 60 CPT hours in total before submitting an application to be relicensed with the SFC. This may sound quite challenging, but if it can be demonstrated that particular courses that you took are equally relevant to the various types of regulated activities which you are applying for, the same courses may be counted towards the required CPT hours for the respective regulated activities. You need to be prepared to provide a description of the courses and explain how these courses (including the courses related to Hong Kong regulatory knowledge) are relevant to the different types of regulated activities for which a licence is being sought.

### CPT obligations

As we are approaching the end of this CPT year, all licensed individuals should ensure they will be able to fulfil their 2022 CPT requirements. If your company has licensed individuals who still need CPT hours, you need to remind them to do so over the coming weeks.

From 2022 onwards, licensed representatives are required to take a minimum of 10 CPT hours while responsible officers are required to undertake at least 12 CPT hours (both regardless of the types of regulated activities they engage in). Out of the required hours, all licensed individuals are required to obtain at least five CPT hours on topics directly relevant to the regulated activities for which they are licensed, and two CPT hours on topics relating to ethics or compliance. In addition, responsible officers will also need to attend two CPT hours on topics relating to regulatory compliance. Please contact us if you require any assistance with meeting your CPT obligations.

## Recent publications

[Virtual rights for virtual goods?](#)

[Hong Kong enacts new regime taxing foreign source income](#)

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