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New Capital Investment Entrant Scheme

Pinky Siu and Adrian Leung

Introduction

On 19 December 2023, the Hong Kong Government announced the details of the new Capital Investment Entrant Scheme (**New CIES**) at a press briefing, led by the Secretary for Financial Services and the Treasury, Mr Christopher Hui. The New CIES is one of the eight policy measures proposed under the Policy Statement on Developing Family Office Businesses in Hong Kong in March 2023.

Under the New CIES, eligible investors who make investments of at least HK\$30 million in the permissible investment assets will be able to apply for residency in Hong Kong.

Because of the aim to strengthen the development of the asset and wealth management, financial and related professional service sectors in Hong Kong, the scope of eligible collective investment schemes (**Eligible CIS**) which will qualify as permissible investment assets under the New CIES is largely expanded.

Scope of Eligible CIS under the New CIES

Under the New CIES, Eligible CIS include:

- (i) Securities and Futures Commission (**SFC**)-authorised funds managed by corporations licensed by or institutions registered with the SFC for Type 9 regulated activity (**Type 9 Managers**);
- (ii) SFC-authorised real estate investment trusts managed by Type 9 Managers;
- (iii) SFC-authorised Investment-Linked Assurance Schemes issued by insurers permitted to carry on Class C business as specified in Part 2 of Schedule 1 to the Insurance Ordinance (Cap. 41); and
- (iv) open-ended fund companies (**OFCs**) registered under the Securities and Futures Ordinance (Cap. 571) and Type 9 Managers.

In addition to the above, ownership interest in limited partnership funds (**LPFs**) registered under the Limited Partnership Fund Ordinance (Cap. 637) is also a type of permissible investment assets.

Key observations

In respect of the expansion of the scope of funds qualifying as permissible investment assets, the following are our key observations:

- All SFC-authorized funds managed by Type 9 Managers are in scope. There are no longer requirements on (i) the underlying investments of the Eligible CIS or (ii) the currency of denomination of the fund. Previously, under the old scheme, an Eligible CIS had to invest at least 70% of its average net assets in other permissible investment assets as specified (i.e. HK\$ equities, debt securities, certificates of deposits, subordinated debt, etc.), and had to be denominated in HK\$ or offer HK\$ share class.
- Hong Kong OFCs and LPFs are in scope, regardless of whether they are authorised by the SFC for sale to the public in Hong Kong. This implies that private funds in these legal forms are in scope too.

Based on the announcement, the eligibility criteria of an Eligible CIS appear to be significantly relaxed compared to the previous scheme, which is consistent with the aim of the New CIES to attract asset owners to set up in Hong Kong and tap into the diverse investment opportunities in Hong Kong by deploying and managing their wealth. We will have to wait for further announcements on the application procedures and administrative matters closer to the launch of the New CIES.

The Hong Kong Government has expressed its aim to officially launch the New CIES and invite applications in mid-2024.

Hong Kong plans a retail funds platform

Alwyn Li and Adrian Leung

Introduction

On 4 December 2023, the Hong Kong Investment Funds Association (**HKIFA**) arranged a briefing session together with the Government's Financial Services and the Treasury Bureau (**FSTB**), the Stock Exchange of Hong Kong Limited (**HKEX**), the Securities and Futures Commission (**SFC**) and various market participants regarding a proposed Integrated Fund Platform (**IFP**). The IFP is part of the Chief Executive's 2023 Policy Address, which aims to expand fund distribution, enhance market efficiency and lower transaction costs (see §72(iii)).

Overview of the IFP and its proposed features

The IFP will cover the full distribution cycle and value chain for retail funds in Hong Kong. It will be developed and operated by the HKEX, supported by the FSTB as the policy bureau and the SFC as the regulator. It is anticipated that the platform will be launched by the end of 2024, and the first phase will focus on the B2B (business-to-business) front-to-back distribution lifecycle and will operate inside Hong Kong only. The IFP may eventually expand to cover a B2C (business-to-consumer) model, as well as customers based in the Greater Bay Area. Joining the IFP is entirely voluntary, and distributors are free to keep their existing distribution channels.

The IFP builds on an independent market infrastructure and will be equipped with product admission and distribution capabilities as well as order routing. It will also facilitate the clearing, settlement and payment for different transactions.

The proposed IFP comprises three parts: (i) Communication Hub, (ii) Business Platform, and (iii) Information Portal.

(i) Communication Hub

The IFP will provide an additional communication channel by introducing a centralised network where communications can be exchanged between different platform users so that market efficiency can be increased.

(ii) Business Platform

For basic functions, the IFP will deal with subscription, redemption, and calculation of proceeds, etc. For instance, equity brokers can sell funds directly by connecting to clients via the IFP. The HKEX has yet to decide on the exact functions to be provided, but it is actively considering the provision of nominee services, especially for smaller distributors.

(iii) Information Portal

The IFP will become a central source of information accessible to the public in order to promote transparency. However, the HKEX has not decided on the precise nature and extent of information to be made available.

Future developments and the way forward

To realise the vision for the IFP – i.e. to add diversity and vibrancy into the funds market in Hong Kong, the HKEX is engineering several features into the platform to raise its competitiveness and lower the entry barrier.

Firstly, the HKEX is exploring the feasibility of standardising the distribution process by compiling master template agreements. This aims to shorten the time required on negotiations, which is a pain point in the current regime.

Secondly, by introducing an additional distribution channel, the HKEX expects the IFP to level the playing field for smaller distributors, which are often less favoured in the market as compared to bigger institutions (e.g. banks and insurance companies) due to their orders being smaller in terms of value and size.

Thirdly, the HKEX observed that the majority of equity brokers already have type 1 and/or type 4 SFC licences, but they limit their offerings to equity. As such, the HKEX is actively looking into allowing the brokers to also distribute funds or link the settlement proceeds in the cash market with funds in the IFP. However, the HKEX expressed that it does not intend to co-mingle accounts established under the IFP with the existing accounts that deal with equities. That being said, whilst the IFP would be operated by a separate entity under the HKEX involving a different ecosystem of accounts, certain costs can be shared across entities, e.g., the KYC procedures do not have to be repeated, thereby driving down the overall costs involved.

Fourthly, the interface of the Information Portal will be investor-friendly, with plans to display standardised sets of information beyond the net asset value and assets under management. There are proposals to develop a 'smart sorting' functionality for investors to compare different fund products easily, so as to facilitate cost-effective and comprehensive investment decisions.

Looking forward, the HKEX expressed its eagerness to explore the development and roll-out of the IFP with industry experts and participants.

New streamlined measures for retail funds

Vincci Ip and Chiselle Kam

On 22 December 2023, Hong Kong's Securities and Futures Commission (**SFC**) introduced further streamlined measures for SFC-authorized funds. New / revised forms, frequently asked questions, guides, checklists and confirmations have been published on the SFC's website.

The key streamlined measures are summarised below:

(a) Appointment of investment delegates

- Appointment of a new investment delegate which is currently managing other existing SFC-authorized fund(s) – This no longer requires SFC prior approval, unless the appointment involves a new all-time investment management delegation arrangement or a change in any all-time investment delegation arrangement currently adopted by the fund. One month's prior written notice will generally be required.
- Appointment of a new investment delegate which is not currently managing other existing SFC-authorized fund(s) – This is still subject to SFC prior approval, but the application would be processed by the SFC as a "simple application" and subject to a shorter approval time.
- New fund application with appointment of a new investment delegate which is not currently managing other SFC-authorized fund(s) – The application will be processed by the SFC as a "standard application" and subject to a shorter authorisation time, provided that the new investment delegate has good regulatory records.

(b) Reporting of material breaches

The SFC has issued new ongoing compliance forms to facilitate fund managers' reporting of material breaches. In general, all fund managers are required to complete the standard ongoing compliance form for reporting of material breaches except for the following streamlined measures for UCITS funds.

- Where no Hong Kong investors invest in a UCITS fund or a class of the UCITS fund (as the case may be) during the affected period for a material breach – Fund manager of the UCITS fund is not required to report such material breach to the SFC. This streamlined measure also applies to reporting of a pricing error of a UCITS fund.
- Where there are Hong Kong investors in a UCITS fund during the affected period for a material breach – Fund manager of the UCITS fund is required to file a standard ongoing compliance form for reporting or filing of such material breach with the SFC. If the material breach solely involves a breach of the home regulator's requirements, then the UCITS fund manager may only complete the ongoing compliance form for filing of material breaches under the streamlined measure.

(c) Post-authorisation notifications

- Scheme changes which require SFC prior approval – A shorter prior notice period (i.e. less than one month) is acceptable, provided that written consents from all affected investors have been obtained.
- Notice during prolonged suspension – The requirement to publish, at least once a month via appropriate means, the fact that dealing is suspended can be complied with by issuing notices (in printed and electronic forms) or by posting prominent message(s) on the fund's / management company's website with a hyperlink to the relevant suspension notice published on the website, as permitted by the fund's constitutive documents and offering documents.
- Notice for publication of financial report – Separate notification to inform investors of the availability of a fund's financial report is no longer required if the fund's offering documents have already disclosed the means and the timeframe for investors to obtain the fund's financial report. If the fund's offering documents have to be revised to reflect that no specific notification will be provided upon the publication of financial report, SFC prior approval is not required, but one month's prior written notice should be provided to investors.

(d) Derivative investments

- SFC prior approval is no longer required for a reduction in the extent of use of derivatives. One month's prior written notice will generally be required.
- Further guidance has been provided on the flexibility in the calculation of a fund's net derivative exposure when using options to achieve a structured return profile.

(e) Disclosure guidance

- Clarification that the disclosure guidance set out in the Guide on Practices and Procedures for Application for Authorization of Units Trusts and Mutual Funds (Application Guide), previously referred to as "minimum disclosure requirement", is non-mandatory and for reference only. The SFC has also updated some common examples of risk disclosures for KFS in the Application Guide.

In view of the latest streamlined measures, fund managers are reminded:

1. To review and update the fund's offering documents and/or constitutive documents (if applicable) if they intend to make use of the flexibilities regarding the publication of notice for financial report and prolonged suspension, as well as the revised disclosure guidance set out in the Application Guide. Relevant SFC requirements (including any prior written notice requirement) should be observed.
2. To review and update the internal control measures and policies, e.g. policies on reporting / filing of pricing error and material breach, to reflect the latest SFC requirements and ensure compliance with the SFC requirements on an ongoing basis.

3. To assess the materiality of any breach and report material breaches to the SFC using the appropriate ongoing compliance forms.
4. To use the new / latest version of the SFC forms, checklists and confirmations (published on the SFC's website) for the application to or filing with the SFC.

Paving the way for retail access to spot virtual assets funds in Hong Kong

Joyce Li

At the start of the new year, the U.S. asset management industry welcomed the highly anticipated approval of the listing and trading of spot bitcoin exchange-traded funds (**ETF**) from the U.S. Securities and Exchange Commission.

Although the Securities and Futures Commission of Hong Kong (**SFC**) has yet to authorise investment funds that invest directly in virtual assets¹ (**VA**), the SFC has always recognised the rapidly evolving VA landscape and the increasing popularity and demand for investment products providing exposure to VA, including VA-related ETF. As early as October 2022, the SFC started accepting applications for ETFs that obtain exposure to VA primarily through futures contracts. As a major boost to Hong Kong's fast-growing VA ecosystem, the SFC issued a new [Circular on SFC-authorised funds with exposure to virtual assets](#) on 22 December 2023 (**Circular**) (which supersedes the October 2022 version) to pave way for the authorisation of investment funds with exposure of more than 10% of their net asset value to VA, enabling retail access to funds with exposure to VA.

The Circular sets out the requirements for authorisation of funds, other than recognised jurisdiction schemes (including UCITS funds) and funds authorised under mutual recognition of funds arrangements (**MRF**), that may have an exposure of more than 10% of their net asset value in VA by:

- (i) investing directly in the same spot VA tokens accessible to the Hong Kong public for trading on SFC-licensed virtual assets trading platforms (**VATP**) (i.e. direct exposure); and/or
- (ii) acquiring indirect investment exposure to such VA (i.e. indirect exposure), for example, through futures traded on conventional regulated futures exchanges and other exchange-traded products (collectively, "**SFC-authorised VA Funds**").

UCITS and MRF managers will need to consult the SFC separately before offering such schemes to the retail public in Hong Kong.

The SFC's requirements under the Circular are summarised below.

What are the additional requirements on management companies?

The management company of an SFC-authorised VA Fund will need to:

- (i) have a good track record of regulatory compliance;
- (ii) have at least one competent staff member with relevant experience in the management of VA or related products. If the key personnel of the management company do not meet this requirement, a separate individual will need to be identified; and
- (iii) be subject to the terms and conditions for licensed corporations or registered institutions which manage portfolios that invests in virtual assets imposed by the SFC's licensing department.

¹ "Virtual asset" refers to any "virtual asset" as defined in section 53ZRA of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance.

What are the custodial requirements for SFC-authorized VA Funds?

The trustee/custodian of an SFC-authorized VA Fund should only delegate its VA custody function to (i) an SFC-licensed VATP, or (ii) an authorised institution which meets the expected standards of VA custody issued by the Hong Kong Monetary Authority (**HKMA**) from time to time (**VA Sub-Custodian**).

In addition, the trustee/custodian and VA Sub-Custodian must (i) hold client assets on a segregated basis (ii) store most of the VA holdings in a cold wallet (the amount and duration of VA holdings stored in the hot wallet should be minimised as much as possible, save for meeting the needs of subscriptions and redemptions) and (iii) ensure the seeds and private keys are securely stored in Hong Kong, tightly restricted to authorised personnel, sufficiently resistant to speculation and properly backed up to mitigate any single point of failure.

What are the eligible underlying VAs?

Currently, eligible underlying VAs are those VA tokens that are accessible to the retail public of Hong Kong for trading on SFC-licensed VATPs.

Are there any additional requirements on the investment strategy of an SFC-authorized VA Fund?

An SFC-authorized VA Fund may make direct and/or indirect investments in eligible VA tokens.

In addition, investments in eligible VA tokens will need to be made in accordance with the following:

- (i) there should be no leveraged exposure to VA at the fund level.
- (ii) if the SFC-authorized VA Fund intends to use VA futures, it should only invest in VA futures that are traded on conventional regulated futures exchanges. The management company will also need to demonstrate that the relevant VA futures have adequate liquidity and the roll costs of the relevant VA futures are manageable.
- (iii) if the SFC-authorized VA Fund primarily adopts a futures-based investment strategy, an active investment strategy is expected to be adopted.
- (iv) if indirect exposure to eligible VA is gained through other exchange-traded products, applicable provisions under the Code on Unit Trusts and Mutual Funds (**UT Code**) will need to be complied with.

Where can SFC-authorized VA Funds transact and acquire spot VA?

Transactions and acquisition of spot VA should be done through SFC-licensed VATPs, or authorised institutions (or subsidiary of a locally incorporated authorised institution) in compliance with the HKMA requirements.

Can SFC-authorized spot VA ETFs accept in kind subscriptions and redemptions?

Yes, subject to the requirements in the Circular, SFC-authorized spot VA ETFs may accept in-kind and/or in-cash subscriptions and redemptions.

How should spot VAs be valued?

When valuing spot VAs, management companies should adopt an indexing approach based on VA trade volume across major VA trading platforms.

What are the other points to note?

The management company of an SFC-authorized VA Fund should ensure that all necessary service providers are competent, available and ready to support the SFC-authorized VA Fund.

As with all SFC-authorized funds, the management company should also ensure that the offering documents of SFC-authorized VA Funds disclose the investment limits and key risks relating to the fund's VA exposure.

Given the novelty of VAs and VA-related products, management companies should carry out investor education before launching any SFC-authorized VA Fund to ensure that investors understand the features and risks relating to such fund.

Last but not least, it is important to note that the requirements set out under the Circular are additional to the applicable requirements under the Overarching Principles Section of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products, the UT Code and the relevant requirements in the joint circular on intermediaries' virtual asset-related activities.

What are the next steps for management companies wishing to offer SFC-authorized VA Funds?

As a first step, the management companies should identify at least one competent staff member with relevant experience in the managing VA or related products.

It will also be important to discuss with relevant service providers, in particular the trustee/custodian and potential VA Sub-Custodian, to put in place the relevant delegation arrangements meeting the SFC's requirements. Internal systems and controls will also need to be enhanced, as necessary, to support the management and ongoing operation and monitoring of an SFC-authorized VA Fund.

Prior consultation and prior approval of the SFC will be required before launching an SFC-authorized VA Fund or before enabling an existing SFC-authorized fund to gain an exposure of more 10% of its net asset value in VA (whether directly or indirectly).

Although not specifically mentioned in the Circular, management companies of funds wishing to invest less than 10% of their net asset value in VA are also expected to consult the SFC prior to doing so. The SFC requirements for such funds are not detailed in the Circular, however, the SFC may impose certain requirements on a case-by-case basis.

With the issuance of the Circular, will we see the first SFC-authorized fund investing in spot VA in the next 12 months?

SFC announces review of brokers' internal controls for protecting client assets

Scott Carnachan and Connie Chan

The Securities and Futures Commission (**SFC**) announced on 23 January 2024 that it will commence in February 2024 a circularisation exercise which comprises a review of the internal controls of selected securities brokers and obtaining direct written confirmation from selected clients. The review will be conducted by the SFC in conjunction with an external accounting firm.

Focus of the internal control review

Client assets protection has always been one of the major focuses in the SFC's supervision of licensed firms. The internal control review will focus on the brokers' internal control systems that are designed to protect client assets as well as their compliance with the expected regulatory standards set out in the following SFC circulars in relation to safeguarding client assets and prevention of fraud:

- i. [Review of internal controls for the protection of client assets and supervision of account executives and a self-assessment checklist](#) issued on 19 December 2018;
- ii. [Third-party deposits and payments](#) issued on 31 May 2019;
- iii. [Operation of bank accounts](#) issued on 28 June 2021; and
- iv. [Managing the risks of business email compromise](#) issued on 24 March 2022.

The SFC's findings after the circularisation exercise in 2017

The SFC conducted similar exercises in 2006, 2012 and 2017. The circularisation exercise in 2017 covered 11 small to medium-sized securities brokers. In its report following the circularisation exercise in 2017, the SFC identified a number of deficiencies, including (amongst others) the lack of effective written policies and procedures or maker-checker controls in key operational areas, the lack of controls over changes to client information, inadequate reviews to identify suspicious sharing of correspondence addresses, lack of policies to identify and protect dormant accounts, and insufficient compliance checks of client accounts.

The SFC also noted that most of the control deficiencies identified during the circularisation exercise in 2017 had been identified in previous SFC circulars.

Next steps

In light of the upcoming circularisation exercise, now would be a good time for responsible officers of brokers to carefully consider the above-mentioned circulars again and review their internal controls to assess whether any enhancements are necessary. Where a broker has identified any problematic issues, the firm should work towards enhancing its controls to ensure compliance with the regulatory requirements. Even though there may not be enough time to address certain issues before this circularisation exercise, it would be preferable if the responsible officers are able to confirm to the SFC that the firm is in the process of enhancing its internal controls.

If you would like us to advise on client asset protection or conduct a review on the operations of your firm, please do not hesitate to contact us.

The SFC's circular is available at [this link](#).

Hong Kong SFC licensing and compliance hints – January 2024

Rebecca Yip

What are the 2024 compliance action items for licensed companies?

- **2024 business plan:** Are there any anticipated changes to your business activities? If so, have you considered the following:
 - whether such changes may impact your existing licenced status (including any conditions imposed on your licence);
 - any potential impact to your MIC arrangements;
 - your ability to comply with the SFC's Financial Resources Rules, record keeping arrangements, and internal control policies and procedures;
 - does the SFC need to be notified or any prior approval sought?
- **Audit questionnaire:** please be reminded that auditors of licensed corporations are required to complete and submit the updated version of Audit Questionnaire as at the end of the licensed corporation's financial year in respect of any period ending on or after 1 December 2023. The revised version of the audit questionnaire is available on the SFC website: <https://www.sfc.hk/en/Forms/Intermediaries/Audit-questionnaire>
- **BRMQ:** have you considered the current version of the Business & risk management questionnaire that you will need to complete for this year?
- **AML:** have you reviewed your existing AML/CFT systems lately? We recommend you consider the latest AML/CFT self-assessment checklist posted by the SFC on 14 November 2023.
- **CPT:** have you planned your CPT calendar to ensure that your licensed individuals obtain their minimum hours well in advance of the December 2024 deadline?
- **Be prepared to enhance your cybersecurity measures:** As mentioned in our September 2023 newsletter, the SFC has commenced a cybersecurity review of selected licensed brokers, traders, global financial firms and online distribution platform operators, focusing on their compliance with the regulatory standards on cybersecurity management and operational resilience. The review covers cybersecurity management and incident reporting, cloud security controls and governance, vendor risk management and remote access controls, amongst others. The findings of the cybersecurity review will form the basis for further regulatory guidance in due course.
- **Routine inspection:** if you have not been subject to an SFC routine inspection within the last four to five years, you should start preparing in anticipation of your next routine inspection. We recommend a proactive rather than a reactive approach.

Deadline reminder

The deadline for the submission of responses to the SFC's and HKMA's joint annual survey on the sale of non-exchange-traded investment products by Type 1 or 4 licensed corporations and registered institutions for the year 2023 is coming up – see the circular of [8 December 2023](#). Licensed entities that did not sell any non-exchange traded investment products during 2023 should have already submitted their survey by 19 January 2024. Licensed entities that sold non-exchanges traded investment products must submit their completed survey by 23 February 2024 (where their total transaction amounts were below HK\$1 billion) or 8 March 2024 (where the total transaction amounts of HK\$1 billion or above).

Recent publications

[Breaking barriers: Hong Kong and mainland China set to reciprocally enforce intellectual property judgments](#)

[New Company Law – Key Changes the Investors in China Need to Know](#)

[Highlights of the Administrative Measures for Cybersecurity Incident Reporting \(Comment Draft\)](#)

[Consultation on legislative proposal to implement regulatory regime for stablecoin issuers, and announcement of introduction of sandbox arrangement](#)

[Code of Banking Practice Update](#)

[HKMA finalizes Basel III final reform package implementation date](#)

[HKMA's Supervisory Policy Manual \(SPM\): CR-S-4 “New Share Subscription and Share Margin Financing”](#)

[Deepening Fintech Innovation Supervisory Cooperation in the Guangdong-Hong Kong-Macao Greater Bay Area](#)

[HKMA publishes the “e-HKD Pilot Programme Phase 1 Report”](#)

[Proposal to enhance the Deposit Protection Scheme to be implemented by early 2025](#)

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