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## New Capital Investment Entrant Scheme

Taylor Hui and Maggie Choi

The New Capital Investment Entrant Scheme (**New CIES**) started accepting applications on 1 March 2024 after the Hong Kong government announced detailed rules. Eligible persons with HK\$30 million (or equivalent) in net assets may apply with the Immigration Department of Hong Kong (**Immigration Department**) for permission to stay in Hong Kong for 24 months which could be further extended for two 3-year terms after fulfilling the relevant investment requirements. Persons who continuously reside in Hong Kong for 7 years or more may apply with the Immigration Department for permanent resident status.

To fulfil the investment requirement under the New CIES, applicants must make a capital investment of HK\$27 million in permissible financial assets (detailed below) and place HK\$3 million in the CIES Investment Portfolio. Permissible financial assets include the following:

- (a) **Equities** - shares of companies listed on the Stock Exchange of Hong Kong (**SEHK**) which are traded either in Hong Kong dollars (**HKD**) or Renminbi (**RMB**).
- (b) **Debt securities** – debt securities (i) listed on the SEHK in HKD or RMB or (ii) listed or issued or fully guaranteed by the government of the Hong Kong Special Administrative Region (**Government**), the Exchange Fund, the Hong Kong Mortgage Corporation, the MTR Corporation Limited, Hong Kong Airport Authority and other corporations, agencies and other corporations wholly or partly owned by the Government.
- (c) **Certificate of deposits** – denominated in HKD or RMB issued by authorised institutions under the Banking Ordinance (**Authorised Institutions**) with a remaining maturity of not less than 12 months at the time of acquisition by the applicant. Investment in certificate of deposits is subject to a cap of 10% (i.e. HK\$3 million) of the minimum investment threshold.
- (d) **Subordinated debt** – in HKD or RMB issued by Authorised Institutions.
- (e) **Eligible collective investment schemes** – (i) Securities and Futures commission (**SFC**) authorised funds which are managed by corporations licensed to perform Type 9 (asset management) regulated activity (**Type 9 Licensees**), (ii) SFC-authorised real estate investment trusts managed by Type 9 Licensees, (iii) SFC-authorised

investment-linked assurance schemes issued by issuers to carry on Class C business (**Authorised Insurers**), and (iv) open-ended fund companies (**OFCs**) registered under the SFC and managed by Type 9 Licensees

- (f) **Ownership interest in Limited Partnership Funds (LPFs)**. Investment in LPFs and in private OFCs (referred to in (e)(iv) above) is subject to an aggregate cap of HK\$10 million of the minimum investment threshold.
- (g) **Non-residential real estate** – subject to a cap of HK\$10 million of the minimum investment threshold.

Save for real estate (referred to in item (g) above), permissible financial assets must be invested through financial intermediaries, the categories of which are: Authorised Institutions, Type 9 Licensees or Authorised Insurers. Only one financial intermediary from each category may be selected by the applicant at the same time.

The permissible financial assets may be managed by the applicant or at the discretion of the financial intermediary. The financial intermediary is responsible for the reporting of the applicant's portfolio to the government agency Invest Hong Kong (**InvestHK**) as well as to comply with ongoing reporting obligations. InvestHK will assess the financial merits of the application and monitor the compliance of the applicant's investment requirement whilst the Immigration Department will assess the application for granting of entry permit, extension of stay and unconditional stay of the applicant.

As mentioned above, the financial intermediary must observe various notification requirements which must be notified to InvestHK / the Immigration Department and the agreement governing the services it provides to applicants should also include such reporting obligations and other specified disclosures under the scheme rules. If applicants are referred to the financial intermediary, it should ensure that proper client due diligence measures are conducted before onboarding the applicant. The financial intermediary should be cautious when dealing with referrers who do not possess the appropriate regulated activity licence with the SFC.

Besides providing discretionary investment management services to applicants, financial intermediaries may also consider expanding the range of financial products available for investment by applicants. As an expansion of the previous CIES scheme, OFCs and LPFs managed by Type 9 Licensees are included as permissible financial assets under the New CIES. With the announcement of the extension of the grant scheme for OFCs by the Government in the recent 2024 Budget, Type 9 Licensees may take advantage of this increase in demand from the New CIES to expand their product range to include OFCs which may be eligible for subsidy under the grant scheme.

## Key points to consider when launching spot virtual asset ETFs in Hong Kong

Pinky Siu and Goofy Chan

Following the issuance of the circular on SFC-authorized funds with exposure to virtual assets ([link](#)) (**VA Funds Circular**) by the Securities and Futures Commission (**SFC**) in December 2023, the industry has been looking forward to seeing the first batch of exchange-traded funds (**ETFs**) being listed in Hong Kong which invest directly in virtual assets (**VAs**) tokens (such as bitcoin and ether) (**Spot VA ETFs**). In this article, we discuss the key issues that a fund manager should address when considering whether to set-up a Spot VA ETF in Hong Kong.

The SFC's key concern for Spot VA ETFs focuses on the competence, availability, and readiness of the service providers to support the direct investments in VAs. Issues to consider include:

- Capability and expertise of trustee/custodian of SFC-authorized funds to discharge custodial functions in respect of VA holdings – Pursuant to the VA Funds Circular, the VA custody function of a Spot VA ETF may be delegated only to an SFC-licensed virtual asset trading platform (**VATP**), or an authorised financial institutions (**AI**) (or subsidiary of a locally incorporated AI) which meets the expected standards of VA custody issued by the Hong Kong Monetary Authority from time to time (**VA Sub-Custodian**).

Where the VA custody function is delegated, the top-level trustee/custodian should map out its relationship with the VA Sub-Custodian, such as the liabilities of the top-level trustee/custodian where the VA Sub-Custodian is at fault or where there is failure on the part of the SFC-authorized VATP, fee arrangement between the top-level trustee/custodian and the VA Sub-Custodian.

Managers should also conduct due diligence on the VA Sub-Custodian to ensure that security procedures are put in place for the Spot VA ETFs in relation to their VA holdings, and should monitor custodian arrangements on an ongoing basis.

- Investible VA tokens – Spot VA ETFs can only invest in VA tokens that are accessible to the Hong Kong public for trading on SFC-licensed VATPs. The list of SFC-licensed VATPs is available on the SFC's website ([link](#)). Managers should ensure that the SFC-licensed VATP(s) to be engaged is competent and ready in handling transactions of VAs on behalf of the Spot VA ETFs. Factors such as the size of market participants on the relevant SFC-licensed VATP(s), trading volume and liquidity of VAs on the relevant VATP(s) should be considered.
- Readiness of participating dealers – For Spot VA ETFs that intend to allow in-kind creation and redemption of units/shares, the managers should check with the participating dealers whether they are sufficiently experienced and are ready to perform their duties when the Spot VA ETFs are listed. For instance, the participating dealers should have sufficient operational flow and competent system design that will enable them to discharge their functions in respect of the Spot VA ETFs. They should also ensure that their SFC licence should contain applicable licensing conditions such that they comply with the "Terms and conditions for licensed corporations or registered institutions which manage portfolios that invest in virtual assets" issued by the SFC ([link](#)) in relation to their Type 1 regulated activity.
- Risks monitoring – Managers should put in appropriate measures in mitigating the key risks pertaining to investments in spot VAs, such as the potential liquidity issue arising from the developing nature of SFC-licensed VATPs; potential risk of delay in acquisition/disposal of VAs on SFC-licensed VATPs where trading volume on the VATPs is low; impact of the difference in the executable price of the spot VA on SFC-licensed VATPs and the valuation price; participating dealers' and market makers' ability to conduct effective arbitrage and provide liquidity. In light of the novelty of the underlying assets of the Spot VA ETFs, it is expected that specific and extensive risk disclosures are required in their offering documents.

Managers who are interested to set up Spot VA ETFs are encouraged to commence negotiation with potential service providers at an early stage to ascertain their abilities to comply with the relevant SFC requirements, and to ensure the viability of the operational model in respect of the VA holdings.

## Changes to the SFC's grant scheme for private open-ended fund companies

Fiona Fong and Sarah Lau

Following announcements during the 2024-25 Budget by the Finance Secretary Paul Chan on the extension of the grant scheme for open-ended fund companies (**OFCs**) and real estate investment trusts (**REITs**) for three years, the Securities and Futures Commission (**SFC**) issued new guidelines on the extended grant scheme (**Extended Scheme**) on 26 April 2024.

For OFCs incorporated in or re-domiciled to Hong Kong and SFC-authorized REITs listed on the Stock Exchange of Hong Kong Limited, the Extended Scheme will continue to cover 70% of eligible expenses paid to Hong Kong-based service providers, subject to a cap of HK\$1 million per publicly offered OFC, HK\$500,000 per privately offered OFC and HK\$8 million per REIT. The Extended Scheme will be applicable for grant scheme applications submitted on or after 10 May 2024 and will be available up to 9 May 2027 on a first-come-first-served basis or where the government's funding is fully committed, whichever earlier. Each eligible investment manager holding a type 9 SFC licence for conducting asset management regulated activities will have a quota of three OFCs under the grant scheme irrespective of whether an application was submitted on or before 10 May 2024.

It is worth noting that the cap available under the Extended Scheme applicable to the incorporation of or re-domiciliation to Hong Kong as private OFCs has been reduced from HK\$1 million under the existing grant scheme (applicable prior to 10 May 2024) to **HK\$500,000** under the Extended Scheme.

For investment managers who have submitted an application for the grant scheme before 10 May 2024, the original parameters of the existing grant scheme will apply and, in respect of private OFCs, the cap of HK\$1 million per OFC will continue to apply.

## Hong Kong SFC licensing and compliance hints – April 2024

Connie Chan

### Computation of liquid capital in Financial Resources Returns: some common mistakes

A licensed firm must at all times maintain the required liquid capital as prescribed in the Securities and Futures (Financial Resources) Rules (**Financial Resources Rules**). Liquid capital is the excess of “liquid assets” over “ranking liabilities”, both of which are defined in the Financial Resources Rules. In this compliance hints section, we have summarized some of the common mistakes we have observed when reviewing licensed firms’ draft financial returns:

1. **Incorrect haircut percentages applied to proprietary positions.** Some firms that have proprietary positions in securities fail to include appropriate haircut percentages to their proprietary positions in the liquid capital computation. Different haircut percentages need to be applied to different types of securities and some investments cannot be included as liquid assets at all.
2. **Accounts receivable arising from non-regulated business included as liquid assets.** Accounts receivable arising from a licensed firm’s regulated activities that meet specific requirements under the Financial Resources Rules can be counted as liquid assets. However, some firms incorrectly include accounts receivable that arise from non-regulated activities as liquid assets.
3. **Concentrated proprietary positions not included as ranking liabilities.** Some licensed firms that have proprietary positions exceeding regulatory thresholds do not include the specified percentages under the Financial Resources Rules as ranking liabilities.
4. **Net positions in foreign currencies not included as ranking liabilities.** Some licensed firms that have net positions in foreign currencies do not include the specified percentage under the Financial Resources Rules as ranking liabilities.
5. **Incorrect set-off of assets against liabilities.** The Financial Resources Rules provide that the assets and liabilities of a licensed firm must be treated separately on a gross basis and must not be set off against each other. However, some firms incorrectly set off certain assets against liabilities.

### Deficiencies identified in the SFC’s and HKMA’s thematic review of the distribution of non-exchange traded investment products

On 18 April 2024, the Securities and Futures Commission (**SFC**) and the Hong Kong Monetary Authority (**HKMA**) jointly issued a [circular](#) that contained their observations following the thematic review of the distribution of non-exchange traded investment products. The circular highlighted some deficiencies in performing product due diligence, suitability assessment, providing information to clients, and ensuring investment products are in the best interest of the clients. These deficiencies include:

1. Senior management of some firms approved investment products for offering to clients despite omissions and errors during the product due diligence process.
2. Some firms failed to conduct a thorough assessment of the characteristics, nature, and extent of risks associated with each investment product that they offered to clients.
3. Some firms failed to show a proper understanding of the nature and level of risks associated with the structured products they sold to their clients. As a result, they were unable to provide clear explanations about the features and extent of risks involved, which made it difficult for investors to make well-informed investment decisions.
4. Some firms lacked adequate procedures to ensure that product due diligence was conducted continuously or at intervals proportionate to the nature, features, and risks of investment products.
5. Some firms overlooked whether the design of the risk profiling questionnaire questions and its underlying scoring mechanism could produce skewed results toward high-risk tolerance.

6. Some firms did not provide clear guidance to staff on the types and categories of investment products that would add to a client's concentration level and failed to properly assess the client's concentration risk.
7. Some firms failed to provide all relevant transaction-related information to their clients, including disclosure of the maximum percentage of monetary benefits that are receivable by them.

Regulators keep a close eye on the distribution of investment products and regularly issue circulars in this regard. Therefore, licensed firms that distribute investment products should focus on the areas covered by these circulars and regularly assess their business to ensure that their operations align with the regulators' expectations.

## Recent publications

[New treasury share regime under the Hong Kong Listing Rules will take effect on 11 June 2024](#)

[New CRCICA Arbitration Rules 2024](#)

[Public Consultation on Proposed Amendments to 2018 HKIAC Administered Arbitration Rules](#)

[Disputes as to proper parties to arbitration agreement may be reviewed by the court](#)

[HKIAC Statistics 2023](#)

[When can the court intervene in a tribunal's decision on public policy?](#)

[When can an arbitral award be set aside for a tribunal's failure to deal with an issue?](#)

[Court emphasizes exceptional nature of challenging arbitral awards](#)

[Court refuses to enforce arbitral award for arbitrator's failure to give reasons for decision](#)

[Major changes in the 2024 CIETAC Arbitration Rules](#)

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[New provisions ease the compliance burden under China's cross-border data transfer regime](#)

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[Contractually obliged to play ball](#)

[Provision of Custodial Services for Digital Assets](#)

[Public consultation on proposal for information sharing among Authorized Institutions to aid in prevention or detection of crime](#)

[Consultation conclusions on the enhancements to the Deposit Protection Scheme](#)

Prudential Measures for Property Mortgage Loans and Other Related Supervisory Requirements

Hong Kong Singapore Fintech Legal Guide

When was the last time you conducted a privacy audit?

**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

**Vincci Ip**  
Partner  
vincci.ip@deacons.com  
+852 2826 5335

**Isabella Wong**  
Partner  
isabellahm.wong@deacons.com  
+852 2825 9577

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

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