

REGULATORY UPDATES (FINANCIAL SERVICES) January 2019 Issue



To maintain the financial stability and facilitate the economic growth of Hong Kong, regulators have been reviewing and establishing different legal framework regularly for financial institutions. In this month, the Hong Kong Monetary Authority (HKMA) and Securities and Futures Commission (SFC) have the following updates:

Supervision for Bank Culture

With a view to gauging the progress of Bank Culture Reform in Hong Kong and providing further guidance to the industry where necessary. On 19 December 2018, the HKMA has published a circular to announce the implementation of the following supervisory measures;

- a) Requiring Authorization Institutions (AIs) to conduct self-assessment
- b) Conducting focus reviews
- c) Undertaking culture dialogues

The HKMA would first commence the self-assessment exercise. The first phase will cover about 30 AIs including all major retail banks and selected foreign bank branches with substantial operations in Hong Kong. As for focus reviews and culture dialogues, the HKMA will inform AIs of the details individually.

[Read more on HKMA's website](#)

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Misconduct Risks in Selling of Investment Funds

The HKMA has published a circular to provide guidance on expected standards for prevention and management of misconduct risks in selling of investment funds on 21 December 2018.

Frequent subscriptions, redemptions and switching of funds may incur substantial commissions and/or other fees and charges, which may significantly undermine the customers' investment returns. Registered Institutions (RIs) should therefore ensure any solicitation or recommendation for fund subscriptions, redemptions and switching is suitable and in the best interest of the customer by implementing the expected standards, covering management supervision, monitoring and review, incentive systems and feedback mechanism, and staff training.

[Read more on HKMA's website](#)

Banking (Exposure Limits) Rules, Banking (Capital) (Amendment) Rules 2018 and Banking (Disclosure) (Amendment) (No. 2) Rules 2018

On 21 December 2018, the HKMA has announced the negative vetting by the Legislative Council of: (i) the Banking (Exposure Limits) Rules ("BELR"), (ii) the Banking (Capital) (Amendment) Rules 2018 ("BCAR") and (iii) the Banking (Disclosure) (Amendment) (No. 2) Rules 2018 ("BDAR") has now expired.

The legislations shall come into force on 11 January 2019 for amendments in (i) Part 4 (except section 34) of BCAR and (ii) sections 15 and 16 of BCAR. On 1 April 2019, the amendments in Part 2 (except sections 15 and 16) of the BCAR, and on 1 July 2019, the amendments of Part 3 and section 34 of the BCAR. Subject to the negative vetting of the Legislative Council, the amendments for the BELR and for the BDAR might also come into forces on 1 July 2019.

[Read more on HKMA's website](#)

The HKMA reprimands and fines JPMorgan Chase Bank for contraventions of the AMLO

On 28 December 2018, the HKMA reprimands and fines JPMorgan Chase Bank, National Association, Hong Kong Branch (JPMorgan Hong Kong) for contraventions of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO) by failing to establish and maintain effective procedures (i) for identifying and handling wire transfers (ii) for the purpose of carrying out its duties concerning customer due diligence (CDD) and continuous monitoring of business relationships respectively.

The HKMA has ordered JPMorgan Hong Kong to submit to the HKMA, by a date and in a manner to be specified by the

HKMA, a report prepared by an independent external advisor assessing whether the remedial measures taken by JPMorgan Hong Kong are sufficient and effective to address the contraventions and other deficiencies identified by the HKMA.

The HKMA has also ordered JPMorgan Hong Kong to pay a pecuniary penalty of HK\$12,500,000.

[Read more on HKMA's website](#)

SFC reprimands and fines SFM HK Management Limited \$1.5 million over naked short selling

The SFC reprimands and fines SFM HK Management Limited \$1.5 million over naked short selling on 6 December 2018 for failures relating to the short selling of Great Wall Motor Company Limited (Great Wall) shares in 2015 on behalf of a fund it managed.

On 28 August 2015, Great Wall announced its proposed bonus issue of shares, which was equivalent to 200% of its existing issued shares and was subject to the fulfilment of certain conditions. The settlement date of the bonus shares was expected to be on 13 October 2015.

The SFC considers that SFM not only failed to act with due skill, care and diligence in dealing in the bonus shares, but also failed to diligently supervise its staff members and implement adequate and effective systems and controls to ensure compliance with the short selling requirements.

[Read more on SFC's website](#)

Clearing Amendment Rules – Addition of Eight New Calculation Periods

The SFC has published a circular regarding the Securities and Futures (OTC Derivative Transactions—Clearing and Record Keeping Obligations and Designation of Central Counterparties) (Amendment) Rules (Clearing Amendment Rules) on 7 December 2018.

The Clearing Amendment Rules were established to provide eight new Calculation Periods, and their corresponding Clearing Thresholds and Prescribed Days. The SFC also reminded the licensed persons to clear relevant transactions in accordance with the Clearing Rules when the average total position in OTC derivatives during a Calculation Period reaches the corresponding Clearing Threshold. Subject to the negative vetting of the Legislative Council, the Clearing Amendment Rules would be effective on 1 March 2019.

[Read more on SFC's website](#)

Distribution of complex and high-risk products

The SFC has published a circular to remind the intermediaries to comply with the regulatory requirements when distributing structured products and corporate bonds with complex features or high risks on 7 December 2018.

In view of the complexity of investment products such as equity-linked accumulators and bonds with non-viability loss-absorption features, which are considered complex products for the purpose of compliance with the Guidelines on Online Distribution and Advisory Platforms and the new paragraph 5.5 of the Code of Conduct. Under these requirements, with effect from 6 April 2019, intermediaries will be required to ensure that a transaction in a complex product is suitable for the client in all circumstances irrespective of whether a solicitation or recommendation is made, and provide information and warning statements about the complex products to the client.

[Read more on SFC's website](#)

SFC-authorized Exchange Traded Funds (ETFs) - List of Potential Events Triggering Ongoing Disclosure

The SFC has issued a circular to management companies of ETFs in relation to the disclosure obligations under the Code on Unit Trusts and Mutual Funds (UT Code) on 17 December 2018.

Pursuant to section 11.1B of the UT Code, management companies are required to notify holders as soon as reasonably practicable of any information concerning the scheme which allows them to appraise the position of the scheme. The SFC has provided examples of events having a material impact on an ETF that may trigger the above on-going disclosure requirements in the circular and stated that management companies have the own duty to decide what and when such information is required to be disclosed.

[Read more on SFC's website](#)

SFC-authorized Funds - Relating to Fair Valuation of Fund Assets

The SFC has published a circular to provide guidance on the valuation policies and procedures of SFC-authorized funds on 17 December 2018.

The SFC stated that it does not prescribe any single approach for valuation of assets. Yet with the purpose of proper investor protection, management companies are reminded to exercise due care, skill and diligence at all times especially valuing the asset at a fair and reasonable price and establishing comprehensive policies and procedures in relation to the use of the fair value price for valuing assets of a fund.

[Read more on SFC's website](#)

Leveraged and Inverse Products structured as ETFs (L&I Products)

The SFC has issued a circular to set out requirements authorising L&I Products for public offering in Hong Kong on 17 December 2018.

In general, L&I Products seeking SFC authorization must meet the applicable requirements in the Overarching Principles Section and UT Code in the SFC Handbook. Given the increasing popularity and technical complexity of L&I Products, the SFC has established additional requirements for the public offering of L&I Products covering the area of a) product naming; b) product structure; c) offering documents disclosure; d) market making arrangements; e) performance simulator; f) distribution; and g) margin financing.

[Read more on SFC's website](#)



Review of internal controls for the protection of client assets and supervision of account executives

The SFC has issued a circular regarding the internal controls review on licensed corporations on 19 December 2018.

The SFC has identified cases of unauthorised trading and misappropriation of client assets which revealed the serious internal control deficiencies in key operational areas and inadequate management supervision of account executives by licensed corporations. The SFC has summarised the major regulatory concerns from the report on the review of internal controls, for example insufficient segregation of duties, inadequate controls to protect client accounts, misaligned incentives in remuneration systems. A comprehensive self-assessment checklist was also published by the SFC for the internal control review and ensuring the compliance with the regulatory requirements.

[Read more on SFC's website](#) (Circular)

[Read more on SFC's website](#) (Report)

[Read more on SFC's website](#) (Checklist)

SFC reprimands and fines Ardon Maroon Fund Management (Hong Kong) Limited \$800,000 for cross trade related failures

The SFC has reprimanded and fined Ardon Maroon Fund Management (Hong Kong) Limited (Ardon Maroon) (now known as China Silver Asset Management (Hong Kong) Limited) \$800,000 for cross-trade related failures in managing the Ardon Maroon Asia Master Fund (AM Fund) on 27 December 2018.

A cross trade that does not involve any change of beneficial ownership is a wash trade which is presumed to be manipulative under the Securities and Futures Ordinance and is not in the best interests of market integrity. The wash trade conducted by the AM Fund was also not in the best interests of the holders of the fund because by doing so, the fund incurred undue transaction costs of over \$133,000.

[Read more on SFC's website](#)

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