REGULATORY NEWSLETTER

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COMPLIANCEDIRECT

REGULATORY UPDATES

Circular to management companies of SFC authorized united trusts and mutual funds – Green or ESG funds

11 Apr 2019

This circular applies to SFC-authorized funds which incorporate the globally recognized green or ESG criteria or principles as their key investment focus and reflect such in their name and investment objective or strategy ("Green or ESG funds").

Background

Globally, climate change; green; environmental, social and governance ("ESG"); or sustainability factors investment products have gained more traction and an international trend in classifying these green or ESG related investment products into Green or ESG funds has emerged. In certain jurisdictions, to be eligible to be classified as Green or ESG funds, certain eligibility and disclosure requirements need to be fulfilled.

In Hong Kong, there are some SFC-authorized funds focusing on green or ESG developments. Preliminary review conducted by the SFC shows the quality of disclosure varies widely. Hence the SFC is now aiming to enhance disclosure comparability between similar types of SFC-authorized Green or ESG funds and their transparency and visibility. This circular shows the SFC's expectation on how the existing UT Code and disclosure guidelines apply to green or ESG funds.

Name of the Scheme

A Green or ESG fund should invest primarily in investments which are green or ESG focused. Green or ESG funds may adopt common ESG investment strategies.

A fund is deemed to "invest primarily" in investments which are green or ESG focused if:

- it adopts screening strategies or thematic investment strategies, and can demonstrate that at least 70% of its total net asset value is invested in green or ESG related investment focus; or

- it adopts other strategies, and can demonstrate to the SFC, on how the fund could comply with this requirement.

Disclosure Requirements

The SFC expects the offering documents of the Green or ESG funds to disclose the following:

a) A description of the key investment focus and targeted objective of the Green or ESG funds;
b) A description of the investment strategies adopted by the Green or ESG fund, including but not limited to:
    a. the relevant green or ESG criteria or principles considered
    b. the expected exposure to the securities or other investments that reflect the stated green or ESG investment focus
    c. the investment selection process and criteria adopted by the Green or ESG fund;
c) a description of whether an exclusion policy is adopted by the Green or ESG fund and types of exclusion;
d) a description of risks associated with Green or ESG fund's investment theme; and
e) any other information, considered necessary by the manager.

Implementation

Existing SFC-authorized funds or new funds seeking the SFC authorization which fall within the scope are required to provide a confirmation to the SFC in the form of:

a) self-confirmation of compliance; or
b) confirmation supported with independent third-party certification or fund label to demonstrate compliance.

For existing SFC-authorized funds to be classified as a Green or ESG fund pursuant to this circular, managers should review the fund's offering documents, and make necessary updates and revisions no later than 31 December 2019.

For new funds seeking SFC's authorization to be classified as a Green or ESG fund, managers should observe the requirements set out in this circular in addition to following the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (including the UT Code).

View Circular

SFC concludes consultation on securities margin financing

4 Apr 2019

The SFC has released consultation conclusions on proposed Guidelines for Securities Margin Financing Activities. The conclusion shows there is general support of the SFC's initiative to provide guidance on the risk management practices expected of brokers when they provide securities margin financing.

Under the new guidelines, brokers should:

- ensure compliance with the maximum total margin loans-to-capital multiple (i.e. 5x) to avoid excessive leverage;
- control the concentration risks posed by holding individual or connected securities as collateral;
- control the concentration risks posed by significant exposure to margin clients; and
- set prudent triggers for margin calls and strictly enforce margin call policies.

This guidance is provided to help brokers set prudent haircut percentages for securities acceptable as collateral and conduct stress testing to assess the financial impact of their securities margin financing activities.

The guideline will take effect on **4 October 2019**.

View Circular

ENFORCEMENT NEWS

The SFC reprimands and fines Nine Masts Capital Limited $1.2 million over naked short selling

The SFC found Nine Masts had received confirmation from a placing agent that it would be allotted 32 million placing shares of Yuzhou. Shortly after the confirmation, Nine Masts sold the 10,633,000 Yuzhou shares, without actually having any existing Yuzhou shares at the time of placing the sell, and the placing had not been completed.

The SFC bans former responsible officer of Guosen Securities (HK) Brokerage Company, Limited for 10 months

The SFC found Guosen had failed to comply with Anti-money laundering ("AML") and counter financing of terrorism ("CFT") regulatory requirements when handling third party fund deposits. And the breach was due to Su's failure to discharge his duties as an RO and a member of Guosen's senior management.

The SFC found Nine Masts failed:

- to act with due skill, care and diligence in dealing in the placing shares, and to implement adequate and effective systems and controls to ensure compliance with the short selling requirements; and
- to improve on the matter despite receiving an advisory letter by the SFC for a similar incident.

View News

The SFC found that Su failed to ensure that Guosen had:

- put in place effective policies to scrutinise and approve third party deposits received by retail clients;
- implemented adequate systems and controls to identify and monitor third party deposits made into its bank sub-accounts;
- communicated and enforced its internal AML/CFT policies effectively; and
- put in place proper procedures for reporting suspicious transactions.

The SFC also found that Su failed to supervise staff members diligently to ensure they adhered to Guosen's AML/CFT policies by:

- documenting the assessment of retail clients' level of risk on money laundering and terrorist financing at account opening
- regularly reviewing and updating existing records of retail clients

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