

---

# REGULATORY NEWSLETTER

2019 Vol. 7



---

## REGULATORY UPDATES

---

### **Prime services and related equity derivatives activities**

**10 Jun 2019**

The Securities and Futures Commission (SFC) sets out the standards of conduct and internal controls it expects of prime brokers (PBs), ie, financial institutions providing prime services and conducting related equity derivatives activities in Hong Kong.

More detailed guidance is set out in the "[Report on the Thematic Review of Prime Services and Related Equity Derivatives Activities in Hong Kong](#)", which provides an overview of the prime services industry landscape in Hong Kong and shares observations and good industry practices noted from the SFC's recent thematic review of the internal controls and risk management processes of selected PBs.

In particular, the SFC would like to highlight the regulatory obligations of PBs in light of the remote booking and operating models and roles of Hong Kong entities when they provide prime services.

PBs are reminded that should PBs or their group companies be impacted by breaches or severe control failures arising from operations in Hong Kong, the SFC will assess the implications of such cases on the fitness and properness of the PBs in Hong Kong.

For details of the requirements, please refer to the circular published by the SFC below.

[View Circular](#)

---

## **Implementation of regulatory requirements for online and offline sale of complex products**

13 Jun 2019

The SFC has provided further guidance by way of the Frequently Asked Questions (FAQs) on the regulatory requirements for online and offline sale of complex products.

The newly added FAQs seek to:

- Clarify that paragraph 5.5 of the Code of Conduct is applicable only when a client purchases a complex product on an unsolicited basis (i.e. no solicitation or recommendation has been made by an intermediary);
- Clarify that the provision of a loan to facilitate a client to purchase a non-complex product would not convert the product into a complex product given that the loan does not alter the terms, features and risks of the product itself;
- Provide guidance on the implementation of the Requirements in the case where an execution broker executes orders placed by an investment adviser or asset manager on behalf of a client; and
- Clarify the SFC's expectation on the disclosure of product information for solicited or recommended repeat purchases generally and for compliance with paragraph 5.5 of the Code of Conduct for repeat purchases of the same complex product or complex products of the same product category.

The full set of FAQs on the Guidelines is also available on the SFC website at [www.sfc.hk](http://www.sfc.hk) under the section "Regulatory functions – Intermediaries – Supervision – FAQs – Guidelines on Online Distribution and Advisory Platforms and Paragraph 5.5 of the Code of Conduct".

In addition, the SFC has added the Netherlands as one of the specified jurisdictions for non-exchange-traded unauthorized funds and security tokens as a type of complex product to the non-exhaustive list of examples of investment products that are considered to be complex products, as set out on the Suitability web page of the SFC's website.

[View Circular](#)

---

## **Foreign exchange margin trading on the Mainland and other activities not regulated by the SFC**

17 Jun 2019

The SFC reminds licensed corporations (LCs) of the following:

- under Mainland law and regulations, it is not legal for any unapproved institution to conduct foreign exchange (forex) margin trading on the Mainland or for any client on the Mainland to entrust an unapproved institution to do so; and
- the risks arising from LCs or their controlling entities and related corporations (collectively, related parties) engaging in or being associated with illegal or fraudulent activities.

### Unauthorised activities on the Mainland

The SFC has noted that the State Administration of Foreign Exchange (SAFE) recently took action against a Mainland entity for soliciting Mainland investors to engage in forex margin trading outside the Mainland on behalf of an online trading platform operated by the entity's offshore shareholder. SAFE advised that the Mainland authorities have not approved any institution to engage in forex margin business either directly or on an agency basis on the Mainland. SAFE also advised that according to Mainland requirements, it is illegal for any unapproved institution to conduct forex margin trading or for any client, whether an organisation or individual, to entrust an unapproved institution to do so.

In this connection, the SFC is aware that some LCs or their related parties offer leveraged foreign exchange trading or similar services to investors via websites presented in simplified Chinese and provide Mainland investors toll free telephone numbers for enquiry. The SFC warns LCs not to engage in unauthorised or illegal forex margin trading on the Mainland or assist other persons or Mainland investors in such activities. LCs which provide or market forex margin trading or similar services to Mainland investors, or assist other persons to provide or market them to Mainland investors, should immediately review the legality of their activities under Mainland law and regulations. Any non-compliant activities should be discontinued immediately and be notified to the SFC in accordance with paragraph 12.5 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

LCs must ensure compliance with the licensing and other requirements of all the jurisdictions in which they operate or provide services and implement sufficient compliance controls. Before commencing business in a jurisdiction, LCs should obtain a thorough understanding of the local legal and regulatory requirements, seek proper legal and professional advice and discuss the applicable requirements with the relevant regulatory authority.

### Alleged fraudulent or illegal activities of related parties

It has also come to the attention of the SFC that some LCs' related parties may be associated with other alleged illegal activities on the Mainland, such as unauthorised stock broking or fraudulent crowdfunding or peer-to-peer lending, or alleged fraudulent London gold activities in Hong Kong. The LCs may have allowed related parties to use their names and SFC licensing statuses on websites or marketing materials to promote these activities. LCs' staff resources or business premises may also be shared with these related parties.

The SFC reminds LCs and their controlling entities to take all necessary steps to review the legality of the services offered by themselves and their related parties to ensure their activities comply with the law and regulations administered by the SFC as well as the applicable requirements of other jurisdictions. Unauthorised or illicit activities must be discontinued immediately. Any contravention of the law or regulations of other jurisdictions may amount to a breach of paragraph 12.1 of the Code of Conduct, which may call into question the fitness and properness of a corporation to be, or to remain, licensed in Hong Kong.

Furthermore, improper conduct by an LC's controlling entity or its other subsidiaries may adversely affect the LC and the group as a whole. Even a perceived association with alleged fraudulent or illegal

activities may have negative implications for an LC's fitness and properness. Accordingly, LCs are urged to take all necessary steps to ring-fence the conduct of related parties suspected of being involved in or associated with dubious activities. These include ceasing co-location or resource sharing arrangements and clearly segregating regulated activities from those which are potentially unauthorised or illegal.

Failure to take appropriate action may impugn on the fitness and properness of the LC, its senior management and its controlling entities, and may result in regulatory action. The SFC may impose conditions on the LCs and their controlling entities to mitigate the risks and where the situation warrants, the SFC will take action which may include issuing restriction notices and suspending or revoking the licence of the LC.

[View Circular](#)

---

## **Amendments to paragraph 5.1 of the Code of Conduct**

**28 Jun 2019**

The SFC reminds licensed corporations (LCs) of the amendments to the Code of Conduct to facilitate new approaches for opening accounts. These changes were made to cater for the need for intermediaries to adapt their practices as business activities are increasingly conducted online.

Paragraph 5.1 of the Code of Conduct requires intermediaries to take all reasonable steps to establish the true and full identity of each of their clients and provides specific guidelines on the acceptable approaches for opening accounts. Following a review of these requirements, the SFC has decided to amend paragraph 5.1 of the Code of Conduct. The amendments were gazetted today and will take effect on 5 July 2019.

### [Launch of a designated webpage](#)

To help intermediaries comply with paragraph 5.1 of the Code of Conduct, acceptable account opening approaches will now be published on a designated webpage, which will also feature relevant circulars and frequently asked questions (FAQs). The information on the dedicated webpage will supersede previous circulars and FAQs on client onboarding. The SFC anticipates that there will be other acceptable options for client onboarding in the future as a result of advances in technology. Intermediaries will be notified of the updates via circulars and publication on the designated webpage.

For the avoidance of doubt, all currently acceptable account opening approaches will remain applicable. The list of examples of a "professional person" who may certify the signing of client agreements and the sighting of a client's related identity documents during account opening will be expanded to include chartered secretaries.

[View Circular](#)

---

## Remote onboarding of overseas individual clients

28 Jun 2019

The SFC informs intermediaries of a new approach for the online onboarding of overseas individual clients which will be acceptable from 5 July 2019 when amendments to paragraph 5.1 of the Code of Conduct take effect.

Impersonation may be harder to detect in remote client onboarding. When clients are not physically present for identification purposes, intermediaries will generally not be able to determine that identity documents belong to the client they are dealing with. Current technology cannot completely eliminate impersonation risks. These may be aggravated by the speed of electronic transactions, multiple fictitious accounts and the use of stolen identities.

Furthermore, the procedures used by overseas banks to verify client identities may not satisfy regulatory requirements in Hong Kong. It may also be difficult for the SFC to conduct an investigation when verification procedures are performed by overseas banks. The new approach to remote onboarding has taken all of these risk factors into account.

### Online onboarding of overseas individual clients

From 5 July 2019, the SFC will accept the approach in the below circular to verify the identity of an overseas individual client provided that all steps listed therein are completed. Please find the link of the circular below:

<https://www.sfc.hk/edistributionWeb/gateway/EN/circular/intermediaries/supervision/doc?refNo=19E C46>

### Further points to note

Senior management of intermediaries, including Managers-In-Charge, bear the primary responsibility of ensuring that proper processes and technologies are implemented to verify clients' identities.

In addition to the pre-implementation assessment and annual reviews, intermediaries should regularly evaluate the performance of the adopted technologies to ensure that the true identities of onboarded clients have been properly established. If an adopted technology becomes particularly vulnerable to a particular type of attack, making it difficult to satisfactorily verify clients' true identities, intermediaries should forthwith cease to use this technology for client onboarding until the relevant concerns have been fully addressed.

Intermediaries should be mindful of the requirements imposed by domestic regulatory authorities when onboarding overseas clients.

[View Circular](#)

---

---

# ENFORCEMENT NEWS

---

## **SFC reprimands and fines Credit Suisse (Hong Kong) Limited and Credit Suisse AG \$2.8 million for regulatory breaches**

The SFC has reprimanded and fined Credit Suisse (Hong Kong) Limited (CSHK) and Credit Suisse AG (CSAG) (collectively, Credit Suisse) \$2.8 million over their failures to comply with the disclosure requirements when they published certain research reports on Hong Kong-listed securities.

The SFC found that CSHK and CSAG failed to disclose their investment banking relationships with subject companies in certain research reports on Hong Kong-listed securities published between 2006 and 11 August 2016. This was caused by an information technology (IT) logic issue in one of Credit Suisse's IT system feeds and it was rectified on 11 August 2016.

In addition, an update by Credit Suisse in August 2016 to revise the market maker disclosure in its research reports led to an inadvertent exclusion of that disclosure from a disclosure template for its research reports. As a result, certain research reports on Hong Kong-listed securities distributed by CSHK or CSAG between August 2016 and 31 May 2017 did not disclose that CSHK was a market maker. This issue was fully rectified on 31 May 2017.

The SFC takes the view that CSHK and CSAG have failed to put in place effective systems and controls to ensure compliance with the disclosure requirements and timely detection of the disclosure failures.

In deciding the penalty, the SFC took into account that:

- CSHK self-reported the two incidents to the SFC;
- CSHK and CSAG have cooperated with the SFC in resolving the SFC's concerns; and
- Credit Suisse has taken remedial measures to rectify the failures and strengthen its internal controls and systems.

## **SFAT affirms SFC decision to reprimand and fine FT Securities Limited \$3.5 million**

The Securities and Futures Appeals Tribunal (SFAT) today affirmed the decision of the Securities and Futures Commission (SFC) to reprimand FT Securities Limited (FTSL) and fine it \$3.5 million for regulatory breaches and internal control failures in relation to preparation and publication of research reports.

FTSL published three equity research reports on its website between July 2012 and April 2013. The SFC found that, during the relevant period:

- FTSL's research reports, which were published in the name of its research analyst, were in fact prepared and written by two unidentified individuals who were not its employees. FTSL did not know their identities, background or contact details, nor did it take any steps to ascertain whether they were related to or had any financial interests in the companies covered in the research reports;
- FTSL falsely disclosed in one of the research reports that it did not provide any investment banking services to the company covered in the research report in the 12 months preceding the publication of the report when in fact it had been appointed as the placing agent for the placing of the company's convertible bonds;
- FTSL had no formal policies or procedures governing the preparation and publication of research reports;
- FTSL did not segregate its research and corporate finance functions to avoid any actual or apparent conflicts of interest. Staff members responsible for handling the placing activities of the company covered in the research report were concurrently involved in the preparation and publication of the report; and
- FTSL failed to demonstrate that there was a reasonable basis for the analyses and recommendations in the research reports.

The SFC concluded that FTSL had failed to supervise its staff members diligently in relation to the preparation and publication of the three research reports, and its internal systems and controls were seriously deficient.

The SFAT accepted that FTSL was culpable of egregious failures to comply with the regulatory requirements addressing analyst conflicts of interest, and its failure to ensure independence and objectivity of research reports might damage investor confidence in the research sector and in the financial services industry more broadly.

[View News](#)

[View News](#)



**ComplianceDirect Consulting Limited**

Address: Unit A, 21/F, Wing Hang Insurance Building, 11 Wing Kut Street, Central, Hong Kong

Phone: 2606 1800

Website: [www.compliancedirecthk.com](http://www.compliancedirecthk.com)

---