

# REGULATORY NEWSLETTER

2022 Vol.2



## Happy Chinese New Year!

Kung Hei Fat Choy! As we step into the year of Tiger, ComplianceDirect will invariably put great effort into providing you with professional consultation and compliance advice, like we always do. On that note, apart from the wishing each other prosperity and wealth, how could we embrace this new year without Regulatory Updates from the SFC which you can share with your friends, co-workers and compliance buddies to celebrate the new beginnings, virtually!

## REGULATORY UPDATES

### Reminder of effective date of revised financial return form and e-submission

21 Jan 2022

The Securities and Futures Commission (SFC) reminds licensed corporations to use the revised financial return form for submitting a return in respect of any period ending on or after 24 January 2022. With effect from 1 February 2022, the electronic submission of financial returns will migrate to the SFC's online platform, WINGS.

A user guide and demonstration videos were published today to provide guidance on how to submit financial returns through WINGS. These new resources are available on the SFC's website under "User Guide – Submission services" on WINGS ([wings.sfc.hk](http://wings.sfc.hk)).

The SFC reminds licensed corporations that they must not make any unauthorized changes to the electronic financial return form. Otherwise, their submissions will be rejected by WINGS.

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## **Anti-Money Laundering / Counter-Financing of Terrorism**

### **Updated AML/CFT Self-Assessment Checklist**

**27 Jan 2022**

The Securities and Futures Commission ("SFC") today posted an updated AML/CFT Self-Assessment Checklist, which reflects the latest Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) ("AML/CFT Guideline"). A copy of the updated checklist can be downloaded from the SFC's website at ([https://www.sfc.hk/-/media/EN/files/IS/AML/AML\\_Self\\_Assessment\\_Checklist\\_EN\\_January\\_2022](https://www.sfc.hk/-/media/EN/files/IS/AML/AML_Self_Assessment_Checklist_EN_January_2022)).

The AML/CFT Self-Assessment Checklist aims to provide a structured framework for licensed corporations ("LCs") and associated entities ("AEs") to assess compliance with the key AML/CFT requirements. LCs and AEs are advised to use the self-assessment checklist as part of their regular review to monitor their AML/CFT compliance.

The senior management of LCs and AEs should ensure that any compliance deficiencies identified during the regular reviews are rectified in a timely manner. In the course of our inspections, we may require LCs and AEs to provide documentary evidence of the performance of such review and its results.

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## **Joint circular on intermediaries' virtual asset-related activities**

**28 Jan 2022**

The SFC and the HKMA has issued an update guidance regarding the additional investor protection measures on the distribution of virtual asset (VA) related activities:

### **A. Distribution of VA-related products**

- Selling restrictions – Except for a limited suite of products discussed below, VA-related products which are considered complex products should only be offered to professional investors. For example, an overseas VA non-derivative ETF would very likely be considered a complex product and it should only be offered to professional investors.
- Virtual asset-knowledge test – Except for institutional professional investors and qualified corporate professional investors, intermediaries should assess whether clients have knowledge of investing in virtual assets or VA-related products prior to effecting a transaction in VA-related products on their behalf. If a client does not possess such knowledge, the intermediary may only proceed if, by doing so, it would be acting in the client's best interests and it has provided training to the client on the nature and risks of virtual assets. Intermediaries should also ensure that their clients have sufficient net worth to be able to assume the risks and bear the potential losses of trading VA-related products. Appendix 1 to this circular sets out non-exhaustive criteria for assessing whether a client can be regarded as having knowledge of virtual assets.

Accordingly, the “professional investors only” restriction is not imposed for the distribution of these products. Nonetheless, as such products are considered complex exchange-traded derivatives, under the existing complex product regime, where there has been no solicitation or recommendation, intermediaries may distribute them without the need to comply with the suitability requirement, but must comply with the existing requirements for derivative products. Intermediaries must also conduct a virtual asset-knowledge test as an additional safeguard.

Intermediaries should also observe the suitability obligations (where applicable) as supplemented by the Suitability FAQs, including:

- Ensuring that any recommendations or solicitations made are suitable for clients in all circumstances. Intermediaries should diligently assess whether the nature and features of the VA-related product (including the effects of gearing and the risks of the underlying virtual assets) are suitable for the client and are in the best interests of the client, taking into account the client’s risk tolerance, financial situation, etc;
- Where the VA-related product is a derivative product, ensuring compliance with paragraphs 5.1A and 5.3 of the Code of Conduct; and
- Conducting proper due diligence on the products, which would include, amongst others, understanding their risks and features (in particular the inherent high-risk nature of the underlying virtual assets), the targeted investors (including any applicable selling restrictions) and the products’ regulatory status. Additional due diligence requirements for unauthorised VA funds are set out in Appendix 4 to this circular.

Given the high-risk nature of virtual assets, intermediaries should be cautious in providing any financial accommodation for investing in VA-related products to clients. Where an intermediary provides financial accommodation to a client, it should assure itself the client has the financial capacity to meet the obligations arising from leveraged or margin trading in VA-related products, including in a worst-case scenario. In the absence of such assurance, the intermediary should not accept instructions from the client.

Intermediaries distributing VA-related products should provide information to clients in relation to VA-related products and the underlying virtual asset investments in a clear and easily comprehensible manner. Intermediaries should also provide to clients warning statements (which can be a one-off disclosure) specific to virtual assets, examples of which are set out in Appendix 5 to this circular.

## **B. Provision of virtual asset dealing services (VA dealing services)**

To provide adequate investor protection, the SFC and the HKMA consider it appropriate and necessary to require intermediaries to partner only with SFC-licensed VA trading platforms<sup>17</sup> (SFC-licensed platforms) for the provision of VA dealing services, whether by way of introducing clients to the platforms for direct trading or establishing an omnibus account with the platforms. Such services should only be provided to professional investors.

The SFC and the HKMA wish to highlight that under the Terms and conditions, intermediaries should only permit clients to deposit or withdraw fiat currencies from their accounts, and should not allow the deposit or withdrawal of client virtual assets, so as to minimize the risks associated with the transfer of virtual assets.

With respect to virtual asset discretionary account management services, licensed corporations providing services which meet the de minimis threshold, i.e., a stated investment objective of a portfolio to invest in virtual assets or an intention to invest 10% or more of the gross asset value of a portfolio in virtual assets, are subject to additional requirements set out in the Proforma Terms and Conditions for Licensed Corporations which Manage Portfolios that Invest in Virtual Assets (RA9 Terms and Conditions) published in October 2019. Going forward, registered institutions wishing to provide such services should inform the SFC and the HKMA and will be required to comply with the RA9 Terms and Conditions which will be imposed as registration conditions.

For discretionary account management services, the SFC and the HKMA wish to further clarify that where a Type 1 intermediary is authorized by its clients to provide VA dealing services on a discretionary basis as an ancillary service, the intermediary should only invest less than 10% of the gross asset value of the client's portfolio in virtual assets.

### **C. Provision of virtual asset advisory services**

Provision of advisory services in virtual assets (VA-advisory services) forms part of an intermediary's advisory business and may therefore affect its fitness and properness to conduct regulated activities. Accordingly, intermediaries are expected to comply with all the regulatory requirements imposed by the SFC and the HKMA when providing advisory services, irrespective of the nature of the virtual assets. Furthermore, such services should only be provided to intermediaries' existing clients to which they provide services in Type 1 or Type 4 regulated activities.

The expected conduct requirements for VA-advisory services are set out in the prescribed Terms and conditions. In particular, intermediaries providing VA-advisory services are expected to observe the suitability obligations. They should offer such services only to professional investors and conduct a virtual asset-knowledge test before providing them.

## D. Implementation

The SFC and the HKMA understand that intermediaries which already engage in VA-related activities may wish to revise their systems and controls to align with the updated requirements. Accordingly, there will be a six-month transition period for intermediaries when serving existing clients of its VA-related activities before the full implementation of the expected requirements in this circular.

Intermediaries which do not currently engage in VA-related activities should ensure that they are able to comply with the requirements in this circular before introducing such services.

Intermediaries are reminded to notify the SFC (and the HKMA, where applicable) in advance if they intend to engage in VA-related activities, which include the distribution of VA-related products and the provision of VA dealing services.

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## ENFORCEMENT NEWS

### SFC reprimands and fines Zhonghui International Futures Company Limited \$5 million for regulatory breaches

20 Jan 2022

The Securities and Futures Commission (SFC) has reprimanded and fined Zhonghui International Futures Company Limited (ZIFC) \$5 million for failures in complying with know-your-client, anti-money laundering and counter-terrorist financing (AML/CFT) and other regulatory requirements between May 2017 and July 2018.

The SFC's investigation found that ZIFC, which permitted 26 clients to use their designated customer supplied systems (CSSs) for placing orders during the material time, had failed to conduct adequate due diligence on the CSSs. As such, ZIFC was not in a position to properly assess and manage the money laundering and terrorist financing and other risks associated with the use of such CSSs by its clients before allowing them to be connected to its broker supplied system (BSS). In addition, ZIFC had failed to implement two-factor authentication (2FA) for clients to login to their internet trading accounts via CSSs for six months until October.

### Market Misconduct Tribunal sanctions Tianhe Chemicals Group Limited and its executive director for issuing false or misleading information in the company's listing prospectus

25 Jan 2022

The Market Misconduct Tribunal (MMT) has found Tianhe Chemicals Group Limited (Tianhe) and its executive director, Mr. Wei Xuan culpable of market misconduct by issuing false or misleading IPO prospectus to overstate the company's revenue by over RMB6.7 billion following proceedings brought by the Securities and Futures Commission (SFC).

The MMT is satisfied that the IPO prospectus contained materially false or misleading information regarding Tianhe's revenues and profits for its track record period for the financial years from 2011 to 2013 and makes the following order:

- Wei, who was a substantial indirect shareholder and chief executive officer of Tianhe at the material time, was disqualified from being a director and being involved in the management of a listed company for four years;

The SFC identified that eight clients have authorized multiple third parties to place orders for their accounts via CSSs. However, ZIFC had failed to take reasonable steps to establish the true and full identity of these clients and their ultimate beneficial owners, nor make proper enquiries before approving the clients' requests to set up the third party operated accounts.

The SFC further found that failure to have in place an effective monitoring system resulted in ZIFC's failure to detect unusual money movements in three client accounts between January and August 2018 and 1,052 instances of self-matched trades in two client accounts between March and May 2018.

The SFC is of the view that ZIFC's conduct was in breach of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance, the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (AML Guideline), the Guidelines for Reducing and Mitigating Hacking Risks Associated with Internet Trading and the Code of Conduct.

- an order that each of Tianhe and Wei shall not perpetrate any conduct which constitutes market misconduct; and
- an order against Tianhe and Wei to pay costs to the Government and the SFC.

The MMT is also satisfied that 53% of Tianhe's total track record revenue of RMB12.6 billion disclosed in the prospectus was overstated. The overstated revenue and profits were likely to induce subscriptions for or purchases of the shares of Tianhe and/or to increase the share price of Tianhe in Hong Kong.

The MMT concludes that Tianhe and Wei were reckless as to whether the overstated revenue and profits in the prospectus were false or misleading when authorizing the issuance of the prospectus.

Tianhe issued the prospectus on 9 June 2014 for its IPO in Hong Kong and raised net proceeds of approximately \$3.52 billion.

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## **SFC reprimands and fines Citigroup Global Markets Asia Limited \$348.25 million for serious regulatory failures over client facilitation activities**

**28 Jan 2022**

The Securities and Futures Commission (SFC) has reprimanded and fined Citigroup Global Markets Asia Limited (CGMAL) \$348.25 million for allowing various trading desks under its Cash Equities business to disseminate mislabeled Indications of Interest (IOIs) and make misrepresentations to institutional clients when executing facilitation trades from 2008 to 2018.

The SFC considers that such pervasive dishonest behavior would not have continued but for serious lapses and deficiencies in its internal controls, compliance function and management oversight.

The SFC is also of the view that CGMAL's failures and misconduct were attributable to the failures by certain former members of its senior management to discharge their supervisory duties. The SFC will commence disciplinary proceedings against these individuals in due course.

CGMAL has taken remediation steps and enhancement measures to rectify and strengthen its internal controls

in respect of IOIs and client facilitation activities, including the appointment of an independent reviewer to review and validate its controls framework.

In deciding the disciplinary sanctions, the SFC took into account all relevant circumstances, including:

- the dissemination of mislabelled IOIs, misrepresentation of the source of liquidity when executing facilitation trades and the exclusion of the requirement for prior consent for facilitation trades from CGMAL's internal guidelines were dishonest and intentional;
- the duration of the misconduct exceeded 10 years and only came to light as a result of the inspection in 2018;
- CGMAL's senior management turned a blind eye to the misconduct by allowing the desks to adopt mislabelled IOIs and perpetrate misrepresentation with a view to achieving business growth;
- CGMAL's compliance function failed to properly discharge its duties;
- CGMAL has since then taken disciplinary actions against and summarily dismissed employees who had engaged in the misconduct;
- CGMAL has taken remediation steps and enhancement measures to stop the misconduct and address the SFC's regulatory concerns;
- CGMAL's cooperation with the SFC in resolving the SFC's concerns and accepting the SFC's findings and disciplinary action; and
- a strong message needs to be sent to the industry to deter other market participants from permitting similar failures to occur.

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