

REGULATORY NEWSLETTER

2022 Vol.7



It's finally that time of year I am complaining about how hot the weather is. To majority of the population, summer is equivalent to enjoying the sunshine, going to the beach, and having a good time with the loved ones. I hold unpopular opinions against all of these: summer, to me personally, means sweaty clothes, incessant rain, and high humidity. I was called an indoor cat by a close friend once, and rightly so.

That's it for ranting. Let's find out what regulatory updates have been issued by the SFC in June, when the highest temperature of the year was recorded.

REGULATORY UPDATES

SFC reminds investors of risks associated with non-fungible tokens

6 June 2022

The Securities and Futures Commission (SFC) wishes to remind investors of the risks associated with investing in non-fungible tokens (NFTs).

The majority of NFTs which the SFC has observed are intended to represent a unique copy of an underlying asset such as a digital image, artwork, music or video. Generally, where an NFT is a genuine digital representation of a collectible, the activities related to it do not fall within the SFC's regulatory remit.

However, the SFC has recently noted NFTs which cross the boundary between a collectible and a financial asset, for instance, fractionalised or fungible NFTs structured in a form similar to "securities", or in particular, interests in a "collective investment scheme" (CIS).

Where an NFT constitutes an interest in a CIS, marketing or distributing it may constitute a "regulated

activity". Parties carrying on a regulated activity, whether in Hong Kong or targeting Hong Kong investors, require a licence from the SFC unless an exemption applies

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SFC proposes amendments to the Securities and Futures Ordinance to strengthen enforcement

10 Jun 2022

The SFC launched a two-month consultation on proposed enforcement-related amendments to the Securities and Futures Ordinance (SFO) to enable it to take more effective enforcement action.

The amendments would broaden the scope of some SFO provisions to expand the basis for the SFC to apply for remedial and other orders against a regulated person under section 213. They would also enable the SFC to address insider dealing perpetrated in Hong Kong involving overseas-listed securities and insider dealing involving Hong Kong-listed securities perpetrated elsewhere.

Other amendments include clarifying an exemption in section 103(3)(k) of the SFO such that, unless authorised by the SFC, advertisements of investment products which are intended to be sold only to professional investors may only be issued to professional investors who have been identified in advance as such by an intermediary through its know-your-client and related procedures.

The consultation paper can be found [here](#).

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Reminder on End-To-End (E2E) Test for the Hong Kong Investor Identification Regime (HKIDR)

17 Jun 2022

Relevant Regulated Intermediaries (RRIs) are reminded to complete the mandatory E2E Test for the HKIDR by [15 July 2022](#). RRIs should refer to the SFC's Circular dated 31 March 2022 for downloading the HKIDR File Transfer Connectivity Guide and relevant E2E test package published by the Stock Exchange of Hong Kong (SEHK) in order to complete the E2E Test.

Please also note that SEHK has updated its HKIDR [File Interface Specification](#) and [File Transfer Connectivity Guide](#), with further details on the submission of the BCAN-CID Mapping File by a third party via SEHK's ECP. Furthermore, SEHK's [Information Paper](#) has been updated to include the requirement for buy-side BCAN reporting by the buying Exchange Participants for an off-exchange trade to SEHK.

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ENFORCEMENT NEWS

SFC reprimands and fines China Everbright Securities (HK) Limited \$3.8 million for breaches of anti-money laundering regulatory requirements

16 Jun 2022

The SFC has reprimanded and fined China Everbright Securities (HK) Limited (CESL) \$3.8 million for failures in complying with anti-money laundering and counter-terrorist financing (AML/CFT) regulatory requirements.

The SFC's investigation, which included a sample review of deposits received by CESL during the relevant period, revealed that CESL failed to identify 178 third party deposits amounting to over \$250 million made through the sub-accounts maintained by CESL with a local bank.

CESL also failed to detect suspicious fund deposits in some of the client accounts and make appropriate enquiries despite the presence of the following red flags:

- 11 clients received five or more deposits from multiple third parties, whose relationships with the clients were unknown;
- the amount of net deposits received by seven clients were not commensurate with their estimated net assets; and
- five clients, who did not appear to have any relationship with each other, received a total of approximately \$5 million from the same third party within four days, and they used the funds to trade in the same stock.

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SFC reprimands and fines CES Capital International (Hong Kong) Co., Limited \$3.2 million for failures in managing private funds

19 May 2022

The SFC has reprimanded and fined CES Capital International (Hong Kong) Co., Limited (CESHK) \$3.2 million over its failure to discharge its duties as an investment manager of two funds between February 2015 and July 2017.

The SFC found that CESHK failed to perform sufficient due diligence and monitoring on the funds' underlying investments and undertake satisfactory risk management measures to identify, quantify and manage the risks exposed to the funds. CESHK also failed to keep proper audit trail of the due diligence and monitoring allegedly performed on the funds and their underlying investments.

In particular, the SFC found that during the relevant period:

- While CESHK was responsible for managing and investing the funds' assets and investments on a discretionary basis, it failed to do so in practice. Instead, the decisions on when to invest for the funds were made by the funds' directors. CESHK considered that its main role was to ensure that the funds' assets were invested substantially in the UCs in accordance with the investment objective stated in the funds' private placement memorandum;
- CESHK had carried out minimal due diligence on the UCs with the result that it had limited or no information on the UCs' holdings of assets, investments and liabilities, and the basis on which the UCs were valued;
- CESHK failed to produce any records of the regular meetings it claimed to have held with its asset management department to review the performance of the funds, and the monthly reports it prepared from May 2016 to March 2017 only set out some data and/or general market views without any accompanying analysis or explanation on their impact on the UCs and/or the funds; and
- CESHK did not maintain any record of its alleged discussions with the funds' directors regarding the significant price drop in one of the funds in around mid-December 2016, nor the basis of its decision to take no further action.

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