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# REGULATORY NEWSLETTER

2025 Vol.2



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Welcome to the January 2025 edition of our Regulatory Newsletter. In this issue, we review the key regulatory developments and updates that have shaped the financial sector over the past month. From recent compliance challenges to evolving regulatory landscapes in Hong Kong and beyond, we provide insights into the trends and changes impacting industry professionals.

At ComplianceDirect, our mission is to keep you informed about the latest compliance issues and regulations that affect your business. We hope this edition of our newsletter proves valuable in helping you stay ahead in an ever-changing regulatory environment. As always, we remain committed to supporting your continued success and are here to guide you through the complexities of today's compliance landscape.

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## REGULATORY UPDATES

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### **Circular to Licensed Corporations, SFC-licensed Virtual Asset Service Providers and Associated Entities**

#### **Findings from inspections on deemed-to-be-licensed virtual asset trading platform applicants and expected standards of conduct for virtual asset trading platform operators**

16 Jan 2025

The Securities and Futures Commission (SFC) has some observations about the systems and processes of deemed-to-be-licensed virtual asset trading platform (VATP) applicants (deemed applicants), after conducting on-site inspections on all of them to ascertain their compliance with the relevant regulatory requirements, including the Guidelines for Virtual Asset Trading Platform Operators (VATP Guidelines).

The appendices to this circular set out the expected standards of conduct for virtual asset trading platform operators (Appendix 1) and the key findings and observations from the inspections, which focused on assessing the deemed applicants' cybersecurity measures, safeguarding of client assets and know-your-client processes (Appendix 2).

Platform Operators, including SFC-licensed virtual asset trading platform operators, deemed applicants and other VATP applicants, are reminded to ensure the proper performance of their business activities through effective resources deployment and procedures<sup>1</sup>. They should also employ fit-and-proper staff who are qualified to act in the capacity so employed (ie, having relevant professional qualification, training or experience). In particular, Platform Operators should deploy adequately qualified staff, expertise, technology and financial resources in designing, developing, deploying, operating and modifying their trading and custody systems.

In light of the regulatory requirements and the observations noted in the appendices, Platform Operators should critically review their policies, procedures, systems and processes, and take immediate action to rectify any inadequacies and deficiencies.

For detailed information and supplementary documents, please refer to the links provided in the circular.

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## Circular on listed structured funds

23 Jan 2025

The **Securities and Futures Commission (SFC)** has issued new requirements for authorising **listed structured funds** for public offerings in Hong Kong under the **Securities and Futures Ordinance (SFO)**. This circular updates guidelines in **8.8 of the Code on Unit Trusts and Mutual Funds (UT Code)** and replaces prior circulars on **Leveraged and Inverse Products (L&I Products)**. It introduces a framework for structured funds, including **L&I Products** and **Defined Outcome Funds**, to meet growing market demand.

### Key Requirements

- **Product Naming:** Names must distinguish structured funds from conventional ETFs and reflect their features (e.g., leverage or inverse factors).
- **Product Structure:** Funds may use derivatives such as futures, swaps, or options-based strategies, subject to liquidity and eligibility criteria.
- **Disclosure:** Offering documents must warn investors about risks like daily rebalancing, heightened volatility, and derivative costs (e.g., roll costs).
- **Market Making:** Providers must ensure at least one market maker, with performance monitored by HKEX. If all market makers resign, the product must be terminated with proper

notice.

### Additional Guidelines for L&I Products

- **Leverage Limits:** Maximum leverage is 2x to -2x, except for **Mainland equity indices**, where inverse products are capped at -1x.
- **Target Investors:** L&I Products are for short-term trading and are unsuitable for long-term, buy-and-hold investors.

### Investor Education and Application

Providers must conduct investor education before launching these products. Intermediaries should ensure proper staff training and compliance with the **Code of Conduct** for derivatives. Funds offering structured payouts or defined outcomes should consult the SFC early in the application process.

This framework aims to protect investors while supporting innovation in Hong Kong's financial market. For detailed information and supplementary documents, please refer to the links provided in the circular.

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## ENFORCEMENT NEWS

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### SFC and HKEX collaborate in enforcement action against FingerTango Inc. and former directors for misconduct resulting in over \$660 million of losses

16 Jan 2025

The Securities and Futures Commission (SFC) and The Stock Exchange of Hong Kong Limited (Exchange) have joined hands in an enforcement action that resulted in the Exchange's disciplinary actions against Mainboard-listed FingerTango Inc. (FingerTango) and its eight former directors for misconduct and breach of their duties towards the company and its subsidiaries.

In parallel, the SFC is also seeking disqualification and compensation orders from the Court of First Instance (CFI) for the same alleged misconduct.

The investigations centred on the directors' misconduct in relation to problematic investments and loans to external parties. Notably, a substantial portion of the loans went into default, resulting in FingerTango and its subsidiaries suffering losses of over \$660 million.

## **SFC's legal action**

Against this backdrop, the SFC commenced its legal action in the CFI in October 2023 seeking various court orders, including disqualification and compensation orders, against FingerTango and its eight former directors. At the time of listing, all then directors, including independent non-executive directors, resolved to adopt a policy that would allow certain investment decisions to bypass board approval. Shortly after its listing in July 2018, FingerTango used proceeds from its initial public offering to invest \$450 million in a fund without the knowledge of the board. FingerTango partially redeemed the fund in December 2019, and immediately invested another \$250 million in loan notes issued by a small-scale private company (2019 Loan Notes). It transpired that FingerTango suffered a loss of \$258.75 million, including accrued interest, from a default on the 2019 Loan Notes.

Subsequently, the SFC discovered that between May 2020 and March 2021, FingerTango and two of its subsidiaries entered into 20 loan agreements with 15 borrowers, for loans totalling over \$500 million (2020-21 Loans). FingerTango subsequently suffered an impairment loss of approximately \$424 million with over 80% of the 2020-21 Loans in default.

In the light of this discovery, in November 2024, the SFC expanded the scope of the misconduct in its legal action to include the 2020-21 Loans and, in particular, former directors' failure to carry out proper procedures and due diligence before entering into the loans. In addition, the SFC named the two subsidiaries of FingerTango as respondents in the legal proceedings.

The SFC alleges that the losses resulting from the 2019 Loan Notes and 2020-21 Loans were attributable to breaches of the duties by former directors of FingerTango, Liu Jie, Wang, Liu Zhangxi, Zhu, Guo and/or Yao, rendering them liable to compensate the company and its subsidiaries for the incurred losses.

## **Message to corporate directors**

The SFC's Executive Director of Enforcement, Mr Christopher Wilson, said: "Corporate directors, including independent non-executive directors, tasked with the governance of a corporation, have the obligation to oversee the activities of management and ensure that adequate internal control policies and procedures are established and operate effectively. Adopting a lax policy which would relieve directors from overseeing important decisions is not an excuse to alleviate directors' responsibility. Their proactive oversight helps reinforce management's commitment to a culture of integrity and promotes ethical conduct throughout the corporation."

"This co-ordinated enforcement action demonstrates the effective regulatory outcome achieved through strategic collaboration between the SFC and the Exchange. As guardians of Hong Kong's capital markets, we strive to achieve quicker and more effective regulatory outcomes in our shared mission to maintain market quality and investor confidence."

In a joint statement issued in July 2023 with the Accounting and Financial Reporting Council, the SFC reiterated the importance of proper conduct in the financial activities of listed corporations, particularly when it comes to granting loans. It emphasised that the board of directors, including audit committees, should be mindful of their duties to prevent the loss or misuse of listed corporations' assets.

## **SFC reprimands and fines Hang Seng Bank Limited \$66.4 million for misconduct in selling practices of investment products**

27 Jan 2025

The Securities and Futures Commission (SFC) has reprimanded and fined Hang Seng Bank Limited (HSB) \$66.4 million for serious regulatory failures in relation to the bank's sale of collective investment schemes (CIS) and derivative products and overcharging its clients and making inadequate disclosure of monetary benefits to them during various periods over the course of nine years between February 2014 and May 2023 (Notes 1 and 2).

### **Sales practices in relation to CIS**

The SFC's disciplinary action stemmed from a referral by the HKMA whose investigation revealed a range of concerns regarding HSB's sale of CIS products during the period from 1 June 2016 to 30 November 2017.

Specifically, 111 client accounts were found to have executed 100 or more CIS transactions during the material period. While most transactions were declared as the client's "own choice", 46 clients had in fact been influenced by their relationship managers' solicitation or recommendation in their trades. They were solicited into conducting excessively frequent transactions with short holding periods, a trading pattern which contradicted both the funds' investment objectives and the clients' preferred investment horizons. The frequent trades in CIS products resulted in significant transaction costs borne by the clients, which greatly affected their overall profit and loss.

HSB's internal controls were deficient in that they did not adequately supervise and monitor the sale of CIS to its clients. In this connection, the bank failed to keep a sufficient audit trail to ensure that transactions were genuinely initiated by clients. It also failed to put in place sufficient controls to monitor and follow up on potentially problematic transactions after they had been conducted.

### **Sale and distribution of derivative products**

The HKMA also referred its investigation findings in relation to HSB's sale and distribution of derivative products to the SFC. From 17 February 2014 to 19 December 2018, 388 clients who were not characterised by HSB as having knowledge of the nature and risks of derivatives purchased derivative funds in 629 transactions, and 148 of these transactions involved products whose risk level was higher than the clients' risk tolerance level.

### **Overcharging and inadequate disclosure of monetary benefits**

A joint investigation by the SFC and the HKMA further found that, during various periods between November 2014 and May 2023, HSB had:

- retained monetary benefits from client transactions in circumstances where it should not have done so under applicable regulatory standards;
- charged its clients transaction fees beyond amounts previously communicated to them; and
- failed to adequately disclose trailer fee arrangements to clients trading in investment funds (Note 3).

In total, HSB received at least \$22.4 million in excess benefits or fees from these transactions.

In light of these findings, the SFC considers that HSB has failed to:

- act with due skill, care and diligence, in the best interests of its clients and the integrity of the market;
- have, or employ effectively, the resources and procedures which are needed for the proper performance of its business activities;
- make adequate disclosure of relevant material information to its clients;
- avoid conflicts of interest and ensure that its clients are treated fairly; and
- comply with all relevant regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its clients.

These issues were first brought to the SFC's attention by self-reports from HSB or referrals of findings from the HKMA. HSB has compensated impacted clients and has taken remediation steps and enhancement measures to rectify and strengthen its internal controls.

The SFC's Executive Director of Enforcement, Mr Christopher Wilson said, "HSB's misconduct in these cases was serious and systemic. In particular, clients who declared making investment decisions themselves were in fact repeatedly solicited by HSB's relationship managers to engage in frequent and excessive CIS transactions. As a result, the clients ended up incurring substantial transaction costs to their detriment. HSB also overcharged a significant number of clients across a multitude of the bank's business lines over an extended period of time. We will not hesitate to take robust enforcement actions against errant intermediaries, and the case underscores our determination to hold intermediaries to the highest standards."

"Our collaboration with the HKMA in this case exemplifies our shared commitment to maintaining the integrity of our financial markets and safeguarding the interest of investors."

Mr Raymond Chan, Executive Director (Enforcement and AML) of the HKMA, said, "This enforcement outcome is a result of close collaboration between the HKMA and the SFC. It helps to send a strong message to the industry that they should have in place adequate systems to ensure compliance with applicable regulatory standards."

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

- HSB's CIS-related failures exposed its clients to significant loss;
- HSB's monetary benefits-related failures occurred during various periods over the course of

nine years and caused its clients to have been improperly charged fees of at least \$22.4 million;

- a strong message needs to be sent to the market to deter other market participants from allowing similar failures to occur;
- HSB compensated clients for their loss and also refunded the excess monetary benefits retained;
- HSB commissioned a number of internal and independent reviews upon discovery and self-reporting of its misconduct and enhanced its internal controls;
- HSB's cooperation with the HKMA and the SFC and acceptance of the SFC's findings and disciplinary action facilitated an early resolution of the matter; and
- HSB has no previous disciplinary record.

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