



ASIA Funds & Financial Services

NEWSLETTER

JANUARY 2024

IN THIS ISSUE

EDITORIAL

Beyond Borders — Hong Kong's Flexible Assistance To Foreign Regulators in Cross-Border Securities Law Enforcement Cases 1

Hong Kong to Bolster Powers to Tackle Misuse of Nonpublic Information..... 2

Hong Kong Continues to Beef up Regulation of Virtual Assets..... 3

REGULATORY STANDARDS/UPDATES 4

INTERMEDIARIES/MARKET SUPERVISION 5

KEY PRODUCT DEVELOPMENTS 6

SIGNIFICANT ENFORCEMENT ACTIONS 6

Sidley's Asia Funds and Financial Services Newsletter discusses important regulatory and enforcement developments that affect financial institutions, investment advisers, and investment funds operating in the Asia-Pacific region in a fast-changing regulatory landscape. In this issue, we cover (among other things) Hong Kong's flexible assistance to foreign regulators in cross-border securities law enforcement cases, the territory's renewed focus on cross-border insider dealing, heightened regulation of virtual assets, and other key updates to regulatory standards and intermediaries/market supervision in Hong Kong and Singapore, including cyber resilience.

EDITORIAL

BEYOND BORDERS — HONG KONG'S FLEXIBLE ASSISTANCE TO FOREIGN REGULATORS IN CROSS-BORDER SECURITIES LAW ENFORCEMENT CASES

The Hong Kong Securities and Futures Commission (SFC), the territory's frontline regulator of the securities market, routinely provides assistance to overseas regulators in cross-border enforcement and non-enforcement-related matters (i.e., supervisory inquiries). This editorial highlights the legal framework and conditions for providing assistance as well as the key limitations and considerations involved.

Hong Kong has a well-developed legal framework for extradition and mutual legal assistance, including various bilateral memoranda of understanding (MOUs) with foreign regulatory agencies. This framework empowers Hong Kong's law enforcement and regulatory agencies to cooperate in cross-border investigations and enforcement actions related to securities and futures trading. Nevertheless, the SFC retains discretion to assist foreign regulators in enforcement and nonenforcement matters regardless of the presence (or absence) of MOUs or similar arrangement with foreign regulatory agencies.

Assistance may include sharing information, taking evidence, and executing search and seizure requests. The SFC has broad powers to enter premises and search, seize, and remove records or documents believed to contain relevant evidence without any legal requirement for warrants to disclose the true purpose of assisting foreign regulators. The SFC can (and frequently does) provide assistance covertly if it is deemed desirable in the interest of the investing public or if it enables the overseas regulator to perform its functions without being contrary to the public interest.

However, the SFC may not disclose information or evidence gathered to overseas regulatory authorities unless it is satisfied that the recipient has adequate secrecy provisions and will not use the information in criminal proceedings. This is a critically important statutory safeguard because the



Visit [sidley.com](https://www.sidley.com) for more information on Sidley's regulatory practice.



powers of investigation conferred on the SFC remove common law privileges such as the right to silence. Individuals are often compelled to answer questions put by the regulator regardless of whether the answer may tend to incriminate them.

If a person claims that providing information may incriminate them, it is vitally important to ensure that extra care is taken that SFC does not transmit the information to the overseas regulator for use in criminal proceedings against the person (although it may be given to the regulator for other purposes, such as proceedings against another person or civil/administrative proceedings). This will aid in preserving the right of a person under investigation to challenge (if necessary) a decision by the regulator to disclose the information without adequate secrecy safeguards or embargoes on use by foreign regulatory bodies in criminal proceedings.

HONG KONG TO BOLSTER POWERS TO TACKLE MISUSE OF NONPUBLIC INFORMATION

There is a clear and renewed focus on insider dealing in Hong Kong this year with the SFC poised to introduce a series of legislative and other measures to bolster its powers to tackle cross-border insider dealing cases and, in tandem, regulate how market participants trade on nonpublic information (regardless of whether it is inside information).

In August 2023, the SFC published its consultation [conclusions](#) on proposed amendments to specifically plug perceived gaps in its ability to prosecute cross-border insider trading cases. Under the current regime, the SFC's ability to bring such cases is limited to securities listed in Hong Kong (or dually listed in Hong Kong and another jurisdiction). The regulator considers that there are two shortcomings under the present regime. First, it lacks jurisdiction to prosecute insider dealing cases involving overseas-listed securities even if the trades are conducted from Hong Kong. Second, it lacks jurisdiction to prosecute insider dealing cases involving Hong Kong-listed securities where the acts are committed outside Hong Kong. In the past five years, the SFC noted that over 60% of insider dealing cases fell into the second category. To cure these perceived defects, the SFC announced it will introduce in the coming year draft legislation to amend the definition of "listed" under the insider dealing provisions to include foreign-listed securities and expressly prohibit insider dealing involving Hong Kong-listed securities no matter where perpetrated.

In October 2023, following a thematic review of market sounding practices and controls in Hong Kong, the SFC separately published a consultation [paper](#) with proposed new *Guidelines for Market Soundings*, which seeks to regulate how market participants can use nonpublic information (regardless of whether it is inside information). Market soundings describes the process used to share nonpublic information with potential investors to ascertain appetite for potential transactions. The purpose of market soundings is to gauge investor interest and determine the specifications of a potential transaction. However, the proposed *Guidelines for Market Soundings* seeks to regulate how market participants trade on nonpublic information obtained during market soundings (regardless of whether the information is price sensitive or constitutes inside information).

If implemented, *Guidelines* will mandate buy-side investors to restrict trading based on all types of nonpublic information obtained during the market sounding process. Market participants will therefore need to exercise extra caution and ensure that they do not exploit or unfairly benefit from any nonpublic information received during soundings (even if not price sensitive), in line with the broad principles under the code of conduct to conduct business honestly and in the best interests of the market. Nevertheless, industry associations have expressed concerns that the proposals are out of step with practices in other international financial markets and risk having a chilling effect on market soundings conducted in Hong Kong.



HONG KONG CONTINUES TO BEEF UP REGULATION OF VIRTUAL ASSETS

In 2023, we saw a plethora of targeted regulations covering the virtual asset (VA) ecosystem in Hong Kong with the SFC continuing to strengthen investor protection by “warning lists” of suspected fraudulent trading platforms. An asset-by-asset analysis is required to determine what regulatory regime applies, with broadly similar standards applying to a wide range of VA-related activities. These standards are designed to protect customer assets, prevent fraud and manipulation, prohibit conflicts of interest, and ensure operational resilience.

For now, if a VA in substance amounts to a securities or futures (SF) contract (as defined under existing laws), then the usual laws and regulations will apply. This means that offers to the public of non-SFC-authorized tokens or those that do not comply with the prospectus regime can only be made to professional investors or pursuant to one or more of the available private placement exemptions. However, it is a misnomer to believe that the rules do not apply to non-SF VA classes. For instance:

- While some offerings are intentionally structured as securities offerings (as in a security token offering), tokens offered through initial coin offerings or initial exchange offerings may still be considered securities, where
 - the token represents equity or ownership interests in a corporation
 - the token represents debt or a liability
 - the token’s proceeds are managed on a collective basis for profit, thereby constituting a collective investment scheme (CIS)
- Investment portfolios consisting solely of non-SF assets remain regulated if structured as a CIS.
 - The VA requirements apply to intermediaries who distribute shares/units in CIS (even if distributing wholly non-SF portfolios).
 - The VA requirements apply to managers of portfolios including SF contracts (subject to *de minimis* threshold).
- Platforms that are sometimes called “cryptocurrency exchanges” that trade a variety of nonsecurity VAs are required to be licensed depending on (i) the types of products to be traded on them and (ii) whether the platforms are carrying on any business or trading operations in Hong Kong. For example:
 - If the platform provides trading services in nonsecurity tokens only (i.e., BTC, BCH, LTC, ETH) using an automated trading engine (whether online or offline) that matches client orders, this triggers the new Anti-Money-Laundering and Counter-Terrorist Financing Ordinance (AMLO) license.
 - If a platform has been carrying on business in Hong Kong trading non-SF tokens before June 1, it will be deemed compliant so long as it lodges the AMLO license application on or before March 2024.
 - Platforms trading security tokens (i.e., futures) are required to apply for the SFO license, with no transitional/safe harbor arrangements.

Although the SFC has publicly disavowed aspirations for Hong Kong to become a crypto trading hub, it advocates that having clear guidelines to follow in the near term will help shape the way the market is evolving while the regulator ponders the wider question of whether to designate all digital assets as securities in the longer term in place of the presently fragmented regulatory regime. Ultimately, macro sentiment will remain a dominant factor, with rising institutional adoption in tokenized funds and the much-anticipated bitcoin exchange-traded fund approvals widely viewed as major catalysts.



REGULATORY STANDARDS/UPDATES

Suitability Tests Relaxed for Ultra-High-Net-Worth Investors

July 2023: Following a joint circular, the Hong Kong Monetary Authority and the SFC relaxed the requirements for banks and brokers to conduct suitability tests when selling products to sophisticated professional investors (SPIs) who have a portfolio of at least HK\$40 million (or equivalent foreign currency) or HK\$80 million in net assets (excluding primary residence). Importantly, for transactions involving a recommendation or solicitation, intermediaries are not required to match risk tolerance level or knowledge and experience or maintain documentation regarding the rationale under investment recommendations made to the SPI. For transactions without any recommendation or solicitation, intermediaries are not required to perform product due diligence for products that match the SPI's investment criteria.

New Risk Management Guidelines for Futures Trading

August 2023: The SFC published its consultation conclusions on the proposed risk management guidelines for licensed futures brokers, which come into effect on February 25, 2024 (with a 12-month transitional period). The guidelines cover various aspects of risk management, including market risk, client credit risk, funding liquidity risk, safeguarding client assets, stress testing, and trading in futures markets outside Hong Kong. The guidelines also emphasize senior managers' responsibility in managing risks, setting controls and thresholds for applying concessionary margining to clients, managing exposure to overseas executing or clearing agents, and monitoring stress testing requirements.

SFC Endorses Voluntary Code of Conduct for ESG Ratings and Data Products Providers

October 2023: In line with the International Organization of Securities Commissions' recommendations, the SFC announced its support for the development of a voluntary code of conduct by environmental, social, and governance (ESG) ratings and data products providers offering products and services in Hong Kong. The increasing use of ESG ratings and data products in the financial services industry has led to a growth in ESG service providers, which fall outside the SFC's regulatory perimeter. Julia Leung, CEO of the SFC, commented that a voluntary code "will help strengthen transparency, quality and reliability of ESG information used by licensed corporations in their investment decisions" and "mitigate the risk of greenwashing in investment products."

Net-Zero Transition Planning Guidelines for Singapore-Based Asset Managers

October 2023: The Monetary Authority of Singapore (MAS) has proposed new Guidelines on Transition Planning that set out the baseline requirements for asset managers to address the risks and changes associated to shift toward a net-zero economy. The guidelines will be applicable to all licensed fund management companies (FMCs) and registered fund management companies (RFMCs) with discretionary authority over managed portfolios and cover areas such as governance, strategy, portfolio management, engagement and stewardship, and disclosures.

Major Revamp to Rules for Fund Management Companies in Singapore

October 2023: The MAS plans to repeal the regulatory regime for RFMCs. Existing RFMCs must apply for a capital markets services license as an Accredited/Institutional Licensed Fund Management Company (A/I LFMC) to continue fund management activities. New RFMC applications will no longer be accepted from January 1, 2024. If implemented, A/I LFMCs will also have a license condition limiting managed assets to S\$250 million but can request a review from MAS if they plan to manage more. There is no limit on the number of investors or funds managed.



INTERMEDIARIES/MARKET SUPERVISION

New Exemption Framework for SFOs

July 2023: The MAS published a consultation paper with proposals to simplify regulations for single family offices (SFOs) in Singapore. The framework sets out qualifying criteria that SFOs must meet to be exempt from fund management licensing requirements. These criteria aim to ensure that SFOs undergo anti-money-laundering checks by MAS-regulated financial institutions and comply with beneficial ownership reporting regulations. Once implemented, the framework will replace the current practice of granting case-by-case licensing exemptions. Existing SFOs will have a six-month transitional period to comply with the new framework.

SFC Poised to Revamp Cybersecurity Guidelines

September 2023: To address growing concerns about cyber risks and strengthen control measures to defend information systems and data, the SFC commenced a cybersecurity review of selected intermediaries to assess their cybersecurity management and information system resilience. The review covers areas such as cybersecurity controls, cloud security, remote access controls, and management of cybersecurity risks from third-party vendors. It also underscores the SFC's expectation that firms comply with system security-related requirements outlined in the code of conduct and adhere to the baseline requirements stated in the Guidelines for Reducing and Mitigating Hacking Risks Associated With Internet Trading. Following the review, the SFC is expected to issue revamped guidelines and best practices in the coming year.

Hong Kong and Mainland Chinese Authorities Strengthen Cross-Border Enforcement Efforts

November 2023: The SFC and the China Securities Regulatory Commission (CSRC) recently held their 15th high-level meeting on enforcement cooperation along with a joint training event. The meeting focused on enhancing coordination and cooperation to combat cross-boundary securities crimes and misconduct and exchanging experience in anti-money-laundering efforts and the use of artificial intelligence and technology in enforcement cases. Additionally, representatives from the SFC, CSRC, Mainland Economic Crime Investigation Department, and Hong Kong Police Force met to strengthen law enforcement cooperation. The joint training event covered topics such as intelligence analysis, tackling fraud and market manipulation, and intermediary misconduct.

MAS Outlines Key Enforcement Priorities for 2024

September 2023: In its recent Enforcement Report, the MAS outlined its top enforcement priorities for the year ahead with asset and wealth managers as well as the digital asset ecosystem being key focus areas. Asset and wealth managers can expect more frequent supervisory visits to identify internal control weaknesses, with senior managers to be held personally accountable and face strict sanctions. MAS will also seek to address the heightened risks across the digital asset ecosystem through regulations and increased collaboration with foreign regulators and law enforcement agencies to tackle misconduct, maintain market integrity, and protect investors.

SFC Expands Position Limit Regime

December 2023: Following public consultation, the SFC revamped the list of specified listed futures and options contracts that are reportable and (among others) clarified the application of the position limits and reporting requirements to funds and fund managers. The revamped rules take effect on December 22, 2023.



KEY PRODUCT DEVELOPMENTS

Enhancements to Wealth Management and Bond Connect Schemes

September 2023: Following the launch of Stock Connect in 2014 and Bond Connect in 2017, regulators in Hong Kong, Macao, and Mainland China announced plans to enhance the cross-border Wealth Management Connect and Bond Connect schemes. The key enhancements include relaxing of the eligibility criteria for investors, increasing individual investor quotas, broadening the range of eligible investment products, and expanding the scope of participating institutions allowed to market investment products and provide relevant services to individual investors in both the southbound (from Mainland China to Hong Kong and Macao) and northbound (from Hong Kong and Macao to Mainland China) regions. Implementation details and operational guidance remain are being finalized.

Hong Kong to Launch China Treasury Bond Futures

November 2023: The SFC announced the upcoming launch of China treasury bond futures contracts in Hong Kong, with preparations being made by Hong Kong Exchanges and Clearing Limited. The launch aims to meet the increasing demand for hedging tools related to China treasury bonds and promote the participation of offshore institutional investors in the Mainland treasury bond market. The SFC sees this as a significant step in establishing Hong Kong as a leading risk management center for hedging Mainland assets. Regulatory cooperation arrangements between the SFC and CSRC will ensure market integrity and support the long-term development of these futures contracts.

SIGNIFICANT ENFORCEMENT ACTIONS

We highlight below several noteworthy disciplinary and enforcement actions in the second half of the year that may be of interest to fund managers, managers in charge/responsible officers (ROs), licensed representatives, intermediaries, and others operating in the Hong Kong financial markets.

Licensing/Financial Resources Rules (FRR) Violations

September 2023: A former RO at a global investment bank was banned for two years over failures to disclose potential conflicts of interest.

September 2023: A fund manager's license was revoked and its RO suspended for five years over (among others) liquid capital deficits (approximately HK\$115,000) and related delays in FRR filings and annual financial reports.

December 2023: A securities broker was reprimanded and fined HK\$1 million for window-dressing its liquid capital.

Internal Control/Anti-Money-Laundering Failures

July 2023: A fund manager was reprimanded and fined HK\$3.4 million over failures to (among others) properly segregate client money by depositing rebates in performance fees to the manager as well as mishandling redemption proceeds.

August 2023: A securities broker was reprimanded and fined HK\$3.5 million over failure to implement effective internal policy on post-trade monitoring and document examination findings/outcomes of unusual transactions flagged by its surveillance system as well as failure to record over 1,000 client telephone order instructions.



September 2023: A former RO of a securities broker was banned for seven months for using internet trading accounts to place orders on behalf of clients without maintaining any proper records of the order instructions from the clients.

September 2023: A securities broker was reprimanded and fined HK\$2 million and its RO suspended for 10 months over failures to (among others) properly monitor cross-trades to ensure fair treatment of clients and monitor employee dealings.

November 2023: A futures broker was reprimanded and fined HK\$2.8 million over failure to conduct due diligence on the customer-supplied systems used by clients for placing orders and failure to effectively monitor transactions to identify and detect suspicious trading patterns in the client accounts.

Insider Dealing/Bribery

October 2023: A former employee of a listco was sentenced to community service and fined HK\$25,000 following criminal conviction for insider dealing in the shares of the listco upon becoming aware of its possible privatization. The court reaffirmed that the starting point is an immediate custodial sentence but imposed a community service order and fine after taking into account the relatively small profit involved (less than HK\$20,000) and early guilty plea.

December 2023: A former front office manager at a retail bank was banned for life (and sentenced to four weeks imprisonment) following criminal conviction after pleading guilty to one count of bribery involving the payment of kickbacks in referral fees for mortgage refinancing.

CONTACTS

Effie Vasilopoulos

Partner

+852 2509 7860

evasilopoulos@sidley.com

Dominic James

Partner

+852 2509 7834

dominic.james@sidley.com

Josephine Law

Counsel

+65 6230 3916

jlau@sidley.com

Reina Chua

Senior Managing Associate

+65 6230 3904

reina.chua@sidley.com

Rix Hoe

Associate

+65 6230 3932

rix.hoe@sidley.com

SIDLEY

AMERICA • ASIA PACIFIC • EUROPE

sidley.com

Sidley Austin provides this information as a service to clients and other friends for educational purposes only. It should not be construed or relied on as legal advice or to create a lawyer-client relationship. Attorney Advertising - Sidley Austin LLP, One South Dearborn, Chicago, IL 60603. +1 312 853 7000. Sidley and Sidley Austin refer to Sidley Austin LLP and affiliated partnerships as explained at sidley.com/disclaimer.