



ASIA Funds & Financial Services

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Sidley's Asia Funds and Financial Services Newsletter discusses important regulatory and enforcement developments that impact 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 top four strategic regulatory priorities, heightened regulation of virtual assets and other key updates to regulatory standards and intermediaries/market supervision, including enhancements to the Monetary Authority of Singapore's (MAS) supervisory powers over financial institutions, particularly licensed fund management companies.

EDITORIAL

HONG KONG'S THREE-YEAR STRATEGIC REGULATORY AGENDA

The Securities and Futures Commission (SFC) recently published its three-year strategic plan for 2024-2026. There is clear and renewed focus by the SFC on minimizing crime and misconduct (including insider dealing), which is part of its top four strategic priorities and regulatory agenda over the next three years, alongside protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation. The SFC (which now boasts its largest ever workforce) intends to prioritize the following four commitments:

- **Maintaining fair, orderly and efficient markets:** The SFC intends to continue to harness technology, leverage surveillance capabilities and explore new regulatory tools to monitor, detect and investigate market misconduct, and foster closer collaboration with regulatory counterparts in Mainland China, overseas and the Hong Kong police to combat financial crime and reduce investment scams in Hong Kong.
- **Strengthen Hong Kong's position in global capital markets:** The SFC intends to encourage innovation and support its status as an international asset and wealth management hub and global fund-raising center, expand and enhance mutual market access programs with Mainland Chinese capital markets, and review and enhance Hong Kong's IPO fund-raising capability as well as market quality and liquidity.
- **Virtual assets and ESG priorities:** advance the regulatory regime for virtual asset trading platforms (VATPs), whilst embracing tokenization of traditional products, safeguarding investors. Roll out and expand sustainability disclosure requirements with the IFRS Sustainability Disclosure Standards, stem greenwashing and work with regional and global leaders to bridge the gap in tackling climate change between emerging and developed economies and promote sustainable finance regulation more generally.

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- **Enhancing resilience and operational efficiency:** The SFC intends to institutionalize operational efficiency by adopting a new organization-wide IT strategy, introducing artificial intelligence to workflows to better monitor (and, if necessary, intervene earlier to shut down) social platforms with the rise of online scams, and stepping up cyber resilience in light of heightened risks.

Keeping these missions in mind, buy-side analysts/fund managers can expect to face heightened regulatory scrutiny when doing due diligence, especially arising from conversations with sell-side brokers, C-suite management, investor relations or someone in the supply chain. This is because the SFC is also poised to implement major changes to the insider dealing regime. Specifically:

- The SFC has signaled it will amend the law to prohibit cross-border trading misconduct.
- The Hong Kong courts have unanimously confirmed the long-arm jurisdiction to pursue enforcement actions regardless of whether (i) perpetrators are resident outside Hong Kong or (ii) the wrongful act takes place outside Hong Kong.
- The Hong Kong courts have also re-confirmed that the starting point is immediate custodial sentence (irrespective of gain).
- The SFC has proposed new guidelines to prevent market abuse when buy-side firms engage in market soundings, which leaves the door ajar to triggering liability regardless of whether or not a regulated person is guilty of any misconduct but simply because a failure to comply will be deemed to adversely affect a person's fitness/propriety. This is plainly very hostile rulemaking as it exposes buy-side firms to disciplinary action even absent a contravention of the law.

NEWS

SINGAPORE TO ENHANCE SUPERVISORY POWERS OVER FINANCIAL INSTITUTIONS

On April 1, 2024, the new Financial Institutions (Miscellaneous Amendments) Act (FIMA) was gazetted paving the way to significantly enhance the regulatory and supervisory framework governing financial institutions, including licensed fund management companies (LFMCs). The key amendments that have the potential to impact LFMCs are as follows:

- **Clarification of Reprimand Powers:** At present, the MAS is empowered to reprimand a "relevant person" if it is satisfied that the relevant person is guilty of misconduct, and if it is necessary in the interest of the public or for the protection of investors. A "relevant person" includes an LFMC, as well as any employee, officer, partner or representative (as applicable) of the LFMC. If implemented, FIMA clarifies that the MAS may reprimand any person who was a "relevant person" at the time of the misconduct, even if they have left the FI (in the case of individuals) or are no longer licensed (in the case of an LFMC).
- **Increased Oversight of Unregulated Business by CMSL Holders:** The amendments will empower MAS to issue written directions on the minimum standards and safeguards that should be in place when capital market services licence (CMSL) holders, including LFMCs, and their representatives conduct certain unregulated "additional business." Additional business includes the dealing in or providing custodial services in relation to (i) payment token derivatives that are not traded on an organised market of an MAS approved exchange, and (ii) spot foreign exchange contracts for a purpose other than leveraged foreign exchange trading.
- **Relaxation of Change of Control Approvals:** At present, MAS approval must be obtained before a person enters into any "arrangement" under which they would obtain "effective" control of a CMSL holder (including LFMC). Such an "arrangement" may be deemed to exist at early stages of negotiations, as it requires only an element of "understanding" between



the CMSL holder and the potential controller. When implemented, FIMA will clarify that a proposed controller is only required to obtain MAS' approval before it takes effective control of a CMSL holder. Accordingly, a potential acquirer may now enter into conditional sale and purchase agreements without securing prior regulatory approval, as long as completion is conditional on MAS approval.

FIMA is expected to come into operation in the second half of 2024, with the exact implementation date still to be gazetted.

SFC WARNS INVESTORS OF END OF SAFE-HARBOR PERIOD FOR VATPS

Effective from June 1, 2024, the SFC has warned investors that all virtual asset trading platforms (VATPs) operating in Hong Kong must either be licensed by the SFC or "deemed-to-be-licensed" VATP applicants (i.e., pre-existing VATPs which were carrying on a business in Hong Kong before June 1, 2023). The SFC stressed that there is no guarantee that deemed-to-be-licensed applicants will be granted a license. Applicants should not actively market their services or onboard new retail clients before being formally licensed. Further, the SFC confirmed that it will reject license applications for platforms who fail to restrict access to Mainland Chinese residents. In such cases, applicants will be required to shutter their businesses in Hong Kong. This policy is expected to significantly impact (if not gate) Hong Kong's attractiveness as a crypto hub.

REGULATORY STANDARDS/UPDATES

SFC Defers Margin Requirements for Non-Centrally Cleared Equity Options

January 2024: The SFC announced the deferral of the local margin requirements for non-centrally cleared over the counter (OTC) single-stock options, equity basket options and equity index options by two years to align with delays in implementation of the UK and EU's timelines and prevent regulatory arbitrage. The requirements will now take effect on 4 January 2026 (deferred from January 4, 2024).

SFC to Enhance REIT Regime and SFO Market Conduct Regime for Listed CIS

March 2024: The SFC published a consultation paper with proposals to introduce a new statutory scheme to facilitate mergers and acquisitions for real estate investment trusts (REITs) as well as enhance the market conduct regime for listed collective investment schemes (CIS). If implemented, the proposals would enable Hong Kong REITs to conduct privatizations and corporate restructurings in a way similar to other listed companies as well as extend the existing market conduct regimes (which currently apply to listed securities in Hong Kong) to net all listed CIS.

Singapore to Repeal Regulatory Regime for Registered Fund Management Companies (RFMC)

March 2024: Following public consultation, the MAS announced that the RFMC regime will be repealed on August 1, 2024. Existing RFMCs intending to continue regulated activities must apply to become an Accredited/Institutional licensed fund management company (A/I LFMC). Successful applicants are expected to be issued a licence by end July 2024, and will have an asset under management cap of S\$ 250 million. RFMCs who fail to submit apply by the deadline will be deemed to have ceased fund management activities unless otherwise exempted from the requirement to hold a capital markets services licence for fund management.



Singapore Amends OTC Reporting Regime

May 2024: Following public consultations by the MAS, the Securities and Futures (Reporting of Derivatives Contracts) (Amendment) Regulations 2024 (SF(RDC)(A)R) was officially gazetted in May 2024. The amendments, which take effect on 21 October 2024, cover, among others, changes to implementation of unique transaction identifiers, changes to the data fields which are required to be reported for each OTC derivatives contract, and the adoption of the ISO 20022 XML message format for OTC derivatives reporting. Fund managers who are subject to the OTC reporting requirements are urged to familiarize themselves with the revisions to ensure compliance with the new reporting format ahead of implementation.

INTERMEDIARIES/MARKET SUPERVISION

SFC Commence Review of Industry Practices to Safeguard Client Assets

February 2024: The SFC appointed KPMG to undertake an internal control review of selected broker-dealers practices for safeguarding client assets. The review will assess brokers' systems for protecting client assets, including controls over client information, money and securities reconciliation, account statements, and trade documents. A similar exercise was performed in 2006, 2012 and 2017. Where appropriate, the SFC may share the findings with the industry.

SFC Advises Market Participants to Assess and Monitor Risks of Shortened Settlement Cycles for U.S. Securities

March 2024: In anticipation of the shift to T+1 settlement cycles for U.S. securities (which took effect on May 28, 2024), the SFC warned market participants to assess their readiness to cope with the shortened timeframe and assess the impact on operational processes, technological infrastructure, systems, and staffing arrangements and take remedial actions. The key risks of trade failures remain the same as under the T+2 environment. The expectation remains (from a regulatory standpoint) that managers should ensure they adopt policies and procedures that comply with the rules and regulations of the markets in which they trade and the specific instruments traded.

KEY PRODUCT DEVELOPMENTS

Wealth Management Connect (WMC) Pilot Scheme Goes Live

February 2024: Beginning February 26, 2024, locally licensed broker-dealers may apply to the SFC to participate in the both the southbound (from Mainland China to Hong Kong and Macao) and northbound (from Hong Kong and Macao to Mainland China) in WMC Pilot Scheme. In general, participating brokers should, at least three months prior to launching activities, notify and obtain a notice of 'no objection' from the SFC before commencing activities. Under the northbound scheme, extra caution is required to ensure that activities undertaken by Mainland Chinese brokers who partner with locally licensed broker-dealers do not breach of the restrictions on carrying on business in regulated activities under sections 114 and 115 of the SFO. Under the southbound scheme, extra caution is required to ensure that locally licensed broker-dealers do not actively market services to the Mainland Chinese public or otherwise offer gifts to induce investors to open accounts or purchase investment products. Detailed guidance, including FAQs, on the eligibility criteria, including entry and ongoing stringent regulatory capital requirements, have been published by the SFC.



SFC Extends Grant Scheme for OFCs and REITs

May 2024: Effective from May 10, 2024, the SFC extended the grant scheme to subsidize the set-up of open-ended fund companies (OFCs) incorporated or re-domiciled to Hong Kong and SFC-authorized REITs listed in Hong Kong for another three years on a first-come-first-served basis. The scheme (first launched in May 2021) covers 70% of eligible expenses paid to Hong Kong-based service providers, subject to a cap of HK\$1 million per publicly offered OFC, HK\$500,000 per privately offered OFC and HK\$8 million per REIT.

SFC Streamlines Authorization Requirements for Exchange-Traded Funds (ETFs)

May 2024: On May 16, 2024, the SFC published a set of general principles that will allow greater flexibility for SFC-authorized feeder ETFs to invest in assets (passively or actively managed) with an overseas-listed master ETF without SFC authorization. Specifically, the master ETF should, at a minimum, be a scheme with: (i) satisfactory safeguards and measures in place to provide substantially comparable investor protection as an ETF-authorized under the Code on Unit Trusts and Mutual Funds, (ii) a good compliance record with the rules and regulations of its home jurisdiction (in the case of its management company and trustee/custodian) and the listing venue (in the case of master ETF itself), and (iii) the master ETF must have sizeable assets under management with a good track record. The feeder ETF must also (among others) be Hong Kong-domiciled and managed by a Type 9 manager.

SIGNIFICANT ENFORCEMENT ACTIONS

We highlight below several noteworthy disciplinary and enforcement actions in the first 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.

Insider Dealing

February 2024: The SFC commenced civil proceedings against four specified persons (including the company secretary of the offeree and the driver of the offeror) for suspected insider dealing involving a take-over offer nearly a decade ago (in 2016) by a private equity firm before the news was made public. After the announcement, the specified persons netted profits of about HK\$325,000 (roughly US\$42,000). The case has been set down for trial in December 2024 (with 10 days reserved).

May 2024: The SFC commenced criminal proceedings against a hedge fund, its director and chief investment officer and former trader for suspected insider dealing prior to a block trade in June 2017. The defendants were released on cash bail totaling HK\$1.5 million (roughly US\$200,000). The case has been transferred to the District Court for prosecution. The first hearing will be held on July 2 when it is anticipated that the defendants will be asked to enter their pleas. If convicted, the Court is empowered to impose (among others) custodial sentences up to 10 years as well as significant fines.

Other Market Misconduct

February 2024: An unemployed retail trader was convicted and jailed for 18 months after pleading guilty to securities fraud involving illegal short selling, which netted an illicit profit of HK\$0.6 million (roughly US\$78,000).

May 2024: Two former brokers were convicted and jailed for three months after pleading guilty to false trading in shares of a company over a period of 10 months.



May 2024: Following a 22-day jury trial, the SFC secured multiple convictions for conspiracy to commit false trading using 156 securities accounts to artificially manipulate the turnover of shares in a listed company resulting in the false or misleading appearance of active trading and an artificial increase in trading volume. The manipulative trading took place over a five-month period in 2016 and netted illicit profits of over HK\$124 million (roughly US\$16 million). The defendants were refused bail and remanded into custody pending sentencing on June 22, 2024.

Senior Management Accountability/Bribery

February 2024: Two former licensed representatives of a securities brokerage firm were banned for five years following criminal convictions for paying kickbacks to software developers for profitable futures trading.

May 2024: A former RO was suspended for four years relating to internal control failures when acting as a placing agent, disclosing confidential contents of the SFC's investigation in breach of the secrecy obligations and knowingly providing false or misleading information to the SFC.

Internal Control/Anti-Money Laundering (AML) Failures

January 2024: A former RO/manager-in-charge of a futures brokerage firm was suspended for 10 months for failing to adequately monitor AML risks associated with client supplied order placing systems and failing to conduct proper enquiries on client deposits which were incommensurate with the clients' declared financial profiles and establish effective ongoing monitoring system to detect and assess suspicious trading patterns in client accounts.

February 2024: A fund manager was reprimanded and fined HK\$2.8 million over failures to properly manage a Cayman fund in line with its stated investment strategy, objectives and investment restrictions (leading to over-concentration of positions in two Hong Kong-listed companies).

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