

Hong Kong: Regulatory Developments Picking Up Pace

This article sheds light on a number of regulatory developments since the 2014 edition of the IFC Review, in particular, consultations on the Professional Investor Regime, Providing Assistance to Overseas Regulators, Publication of NAVs and Prices, An Effective Resolution Regime and Principles of Responsible Ownership. The SFC's charges against Pacific Sun is also discussed. The article has previously been published on the IFC Review earlier in June 2015.

Hong Kong has continued to maintain its status as a leading financial centre throughout 2014-2015 and there have been a number of regulatory developments since last year's edition of *IFC Review*.

Consultation on Professional Investor Regime

In September 2014, the Securities and Futures Commission (SFC) published its consultation conclusions which introduce a new regime governing how licensed and registered persons must deal with professional investors with effect from March 25, 2016. The new regime limits the availability of current exemptions from requirements under the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct). As a result, licensed or registered persons who deal with professional investors who are not true institutional investors will be subject to greater compliance burdens. Licensed or registered persons who rely on the fact that they deal with professional investors to comply with current laws and regulations should review their existing procedures to ensure that they will be able to comply with the new regime.

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In particular, the SFC has decided to (i) continue allowing individual professional investors and corporate professional investors to participate in private placement activities if they meet the prescribed monetary thresholds under the Securities and Futures (Professional Investor) Rules (PI Rules), (ii) not increase the current monetary thresholds under the PI Rules, (iii) not allow intermediaries to be exempt from the suitability requirements under the Code of Conduct or to rely on other exemptions under the Code of Conduct that have a significant bearing on investor protection (such as the need to enter into a written client agreement) when serving individual professional investors, (iv) adopt a principles-based assessment (CPI Assessment) for corporate professional investors, and (v) require the assessment of investment vehicles owned by individual professional investors and by family trusts using the CPI Assessment and only permit those who pass such CPI Assessment to be eligible for the relevant exemptions under the Code of Conduct. The CPI Assessment seeks to establish the financial sophistication of a corporate investor by looking at whether the investor (a) has an appropriate corporate structure and investment process and controls, (b) has persons responsible for making investment decisions who have sufficient investment background, and (c) is aware of the risks involved.

At the same time, as there was widespread public disagreement with the SFC’s previous proposal to require that the suitability requirement under the Code to be incorporated into client agreements, the SFC has now proposed that the following clause be inserted into client agreements *“If we [the intermediary] solicit the sale of or recommend any financial product to you [the client], the financial product must be reasonably suitable for you having regard to your financial situation, investment experience and*

investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause”. The consultation on this further proposal concluded on 24 December 2014 but the comments have not yet been published.

Consultation on Providing Assistance to Overseas Regulators

In December 2014, the SFC published its consultation paper on proposed amendments to the Securities and Futures Ordinance (SFO) to enable further assistance to be provided to overseas regulators. The objective of the proposals is to enable more effective and comprehensive supervision of regulated entities that operate in multiple jurisdictions and to secure access for Hong Kong licensed corporations to overseas markets which require international cooperation arrangements to be in place. Whilst the current framework under the SFO for providing assistance to overseas regulators for enforcement matters meets international norms, for supervisory matters, the current provisions of the SFO fall short. Thus, at present, the SFC is not able to exercise its supervisory powers to obtain information for purposes of assisting an overseas regular in a non-enforcement related matter where the Hong Kong licensed corporation or a company in its corporate group is also regulated by the overseas regulator. The proposals in the consultation relate only to enhancing the SFC’s information gathering powers and no change is proposed to the SFO’s existing provisions regarding information sharing. At the same time, the proposals do not seek to empower the SFC to enter the premises of a corporation on behalf of an overseas regulator or allow the SFC to assist if an overseas regulator requests

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information related to an unregulated activity conducted by a licensed corporation. The consultation conclusions have not yet been published, but the SFC is targeting to table a draft bill before the Legislative Council in June 2015.

Consultation on Publication of NAVs and Prices

In December 2014, the SFC published the consultation conclusions in respect of the consultation that it had concluded in July 2014 regarding the manner and frequency of the publication of various matters under the Code on Unit Trusts and Mutual Funds (Code). The SFC has decided to adopt all of the amendments that were proposed to both the Code and the SFC Handbook with the result that the requirements in respect of the publication of offer and redemption prices (Prices), net asset values (NAV), and notices of dealing suspensions (Suspension Notices) of collective investment schemes (Schemes) authorised by the SFC have changed. With effect from 30 January 2015 (i) Prices, NAVs and Suspension Notices can be published by any appropriate means which may include newspapers, telephone hotlines and websites, and (ii) Prices and NAVs must be published on every dealing day of the Scheme to which they relate. Previously, in the absence of a waiver, publication of these matters had to be made in at least one leading English language and one leading Chinese language newspaper in Hong Kong and Prices and NAVs were only required to be published at least once a month.

Second Consultation on An Effective Resolution Regime

On January 21, 2015 the Financial Services and the Treasury Bureau of the Government (FSTB) in conjunction with, inter alia, the SFC, published a second consultation paper on an effective resolution regime for financial institutions (FIs) in Hong Kong. The first consultation set out proposals to strengthen the options available to the authorities for dealing with a crisis situation in which a systemically important FI fails and poses a threat to the continuity of critical financial services and stability. The second consultation builds on the proposals and the comments that were received thereon and puts forward proposals in respect of the scope of the resolution regime, the regime’s governance arrangements, the resolution powers to be made available under the regime, the safeguards and funding for the regime, and the ways in which resolution actions can be co-ordinated cross-border and information shared for that purpose. In respect of the scope of the regime and its applicability to licensed corporations, it is now proposed that the regime cover only licensed corporations which are themselves designated as non-bank non-insurer (NBNI) global systemically important financial institutions (G-SIFIs) or are subsidiaries or branches of groups which are identified as being or containing G-SIFIs. The criteria for designating NBNI G-SIFIs is to be set out in the consultation conclusions for identifying NBNI G-SIFIs to be published by the Financial Services Board (FSB) and the International Organisation of Securities Commissions. It has been indicated that a third shorter consultation will likely be required in Hong Kong in light of the work still being conducted by the FSB.

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Consultation on Principles of Responsible Ownership

In March 2015, the SFC published its consultation on principles of responsible ownership in which it proposes that guidance (in the form of principles) should be provided on how shareholders should fulfil their ownership responsibilities in relation to their investment in a listed company. Whilst the SFC has stated that the principles are intended to be non-binding and voluntary and that investors will only be encouraged to sign up, once signed up, investors will need to 'comply or explain' (ie, comply with the principles in their entirety and disclose how they have done so, or explain why some or all of the principles do not, or cannot, apply to them). In addition, the SFC is suggesting that certain categories of investors, such as those licensed and regulated by the SFC, could be required to disclose whether or not they comply with the principles and if they do not comply, to explain why. The principles will also be relevant to retail investors in that they will provide guidance on share ownership engagement, but certain elements of the principles, such as disclosure, reporting and accounting to stakeholders, will not expressly apply to individuals. At this stage it is difficult to see exactly what the SFC hopes to achieve by introducing these type of principles and we expect that strong opposition will be raised during the consultation process.

Pacific Sun

The SFC brought charges against Pacific Sun Advisors Ltd., an investment manager, and Andy Mantel, its director, for allegedly breaching the SFO by failing to obtain SFC authorization to issue advertisements in respect of an unauthorised collective investment scheme (CIS). The Magistrates Court correctly acquitted both Pacific Sun and Mr Mantel on the basis that as

the interests in the CIS were sold only to professional investors, the advertisements were exempt from requiring authorisation by the SFC.

The SFC then appealed those acquittals to the High Court arguing that the professional investors exemption was available only if the advertisement itself stated that the interests in the CIS were to be sold or were intended to be sold only to professional investors and that a process to screen investors to assess if they were professional investors was irrelevant. Unfortunately, the High Court agreed with the SFC and the charges were remitted to the Magistrates Court which had no alternative but to convict Pacific Sun and Mr Mantel.

The High Court decision was then appealed to the Court of Final Appeal which, on 20 March 2015, delivered a unanimous ruling restoring the acquittals reached in the original Magistrates Court case and determining that the professional investors exemption under the SFO, s.103(3)(k) exempts the issuance of advertisements in respect of securities (eg, interests in a CIS) as long as the securities are sold or are intended to be sold only to professional investors. In this regard, the ruling stated that *"There is nothing to suggest the legislative purpose of s.103(3)(k) is to protect retail investors from wasting their time or, alternatively, against having their investment appetites whetted."*

This landmark ruling makes it clear that if it can be shown that the issuer of the interests in the CIS has adopted screening procedures to restrict the actual sale of interests in the CIS to professional investors, then the exemption for advertisements in respect of that CIS applies, whether or not such advertisements make it clear that interests in the CIS may only be sold to professional investors or are intended to be sold only to professional investors.

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