

Hong Kong Financial Regulatory Newsletter



Hong Kong Financial Regulatory Newsletter is the latest initiative of Deloitte Global Financial Services Industry (GFSI) practice. This publication provides highlights of the significant developments in regulations of the Hong Kong financial markets and analysis of new laws/regulations published by the SFC, HKMA, HKEx, OCI, HKFI and MPFA since our last edition.

Key regulatory developments:

The Securities and Futures Commission (SFC)

- Notice on Potential Regulations Applicable to, and Risks of, Crowd-funding Activities
- Joint Announcement of China Securities Regulatory Commission and Securities and Futures Commission
- Circular to Issuers of SFC-authorized MPF Products (“MPF Issuers”) - Streamlined Measures to Enhance the Processing of Application for Scheme Changes and Revision of Offering Documents of SFC-authorized MPF Products
- Circular to Licensed Corporations concerning Effective Business Continuity Plans
- Circular to all Licensed Corporations and Registered Institutions concerning the U.S. Foreign Account Tax Compliance Act

The Hong Kong Monetary Authority (HKMA)

- Enhanced Competency Framework for Private Wealth Management (“PWM”) Practitioners (“ECF”)
- New Supervisory Policy Manual (“SPM”) Module RE-1: Recovery Planning
- Implementation of Basel III – Quarterly Template for Reporting of Leverage Ratio
- Risks associated with virtual commodities
- Basel Committee – New Large Exposures Framework
- Control measures for guarding against some recent fraud cases
- Issuance and implementation of a final standard for the capital treatment of bank exposures to central counterparties
- Implementation of new standardised approach for measuring counterparty credit risk exposures

The Hong Kong Exchange and Clearing Limited (HKEx)

- Exchange Publishes Guidance Letter on its Reverse Takeover Rules
- SEHK and HKSCC Issue Participants Circular on Shanghai-Hong Kong Stock Connect

Detailed Summary:

SFC

• **Notice on Potential Regulations Applicable to, and Risks of, Crowd-funding Activities**

The purpose of the notice was to remind parties engaging in crowd-funding activities of the potential application of relevant securities laws and regulations, and to remind the public of the potential risks involved in participating in crowd-funding activities, in view of the increase in such activities internationally and in Hong Kong. Parties which seek to engage in crowd-funding activities should be aware that a breach of the SFO and C(WUMP)O could lead to serious consequences including criminal liability resulting in a term of imprisonment and/or fines. Apart from securities laws and regulations, parties engaging in crowd-funding activities should also check if there may be other Hong Kong laws and regulations which are applicable to their activities and/or their operators including for example those relating to money-lending. Crowd-funding activities may give rise to significant risks, including the following: risk of default, risk of illiquidity and dilution of stock value, risk of platform failure/ insolvency, risk of fraud, platform operating outside Hong Kong, information asymmetry and lack of transparency, cyber security and illegal activities.

Click to read the respective news release.

- **Joint Announcement of China Securities Regulatory Commission and Securities and Futures Commission**

The China Securities Regulatory Commission and the Securities and Futures Commission have approved, in principle, the development of a pilot programme (Shanghai-Hong Kong Stock Connect) for establishing mutual stock market access between Mainland China and Hong Kong. When launched, the pilot programme will operate between the Shanghai Stock Exchange (SSE), the Stock Exchange of Hong Kong Limited (SEHK), China Securities Depository and Clearing Corporation Limited (ChinaClear) and Hong Kong Securities Clearing Company Limited (HKSCC). The announcement described the principles under which it was expected that Shanghai-Hong Kong Stock Connect would operate.

SSE, SEHK, ChinaClear and HKSCC would collaborate with each other to develop the operational and other components of Shanghai-Hong Kong Stock Connect prior to launch, including all necessary arrangements to ensure an orderly market and prudent risk management. Launch of Shanghai-Hong Kong Stock Connect would only take place once relevant trading and clearing rules and systems had been finalized, all regulatory approvals had been granted, market participants had had sufficient opportunity to configure and adapt their operational and technical systems. SSE, SEHK, ChinaClear and HKSCC would, during the development of Shanghai-Hong Kong Stock Connect, and prior to launch, liaise with market participants in relation to all rules, systems and technical requirements relevant to their operations.

Click to read the respective news release.

- **Circular to Issuers of SFC-authorized MPF Products (“MPF Issuers”) - Streamlined Measures to Enhance the Processing of Application for Scheme Changes and Revision of Offering Documents of SFC-authorized MPF Products**

The circular was to introduce the streamlined measures with an aim to enhance the processing of applications for the approval of scheme changes and/or authorisation of revised offering documents of SFC-authorized MPF products (including MPF schemes, constituent funds and approved pooled investment funds) (collectively, referred to as “Applications”). Currently, all scheme changes that fall within 8.2 of the SFC Code on MPF Products (the “MPF Code”) must be submitted to the Commission for prior approval and prior notification is normally required to be provided to scheme participants or fund holders before the changes are to take effect. The revised Hong Kong offering documents reflecting such changes must also be submitted to the Commission for authorisation.

In order to facilitate MPF Issuers for more efficient management of their SFC-authorized MPF products, the Commission has introduced the streamlined measures pursuant to which prior approval would not be required from the Commission in respect of certain immaterial changes proposed to be made to the relevant SFC-authorized MPF products and consequential amendments to their offering documents (collectively, referred to as “Immaterial Changes and Related Revised Documents”). It covers areas of Scheme changes and revised offering documents and Obligations of the MPF Issuers.

Click to read the respective SFC circular.

- **Circular to Licensed Corporations concerning Effective Business Continuity Plans**

An effective business continuity plan is essential to the operations of all licensed corporations. SFC expected all licensed corporations to establish and maintain appropriate internal controls and risk management measures to protect its key business functions and recover them in a timely fashion in the event of operational disruptions. SFC set out a non-exhaustive list of questions to which all licensed corporations may refer when reviewing its business continuity plan. While all licensed corporations are expected to assess your existing business continuity arrangement, all licensed corporations are also reminded to update your information, particularly the emergency contacts, with the Commission on a timely basis.

Click to read the respective SFC circular.

- **Circular to all Licensed Corporations and Registered Institutions concerning the U.S. Foreign Account Tax Compliance Act**

The Circular was issued further to the Commission's Circular of 8 October 2013 for the purpose of updating licensed corporations and registered institutions concerning progress in the discussions between the governments of the Hong Kong SAR and the United States of America in relation to the conclusion of an inter-governmental agreement between them (IAG), which is intended to facilitate compliance with the Foreign Account Tax Compliance Act (FATCA) by financial institutions in Hong Kong. On 9 May 2014, the Hong Kong SAR Government issued a press release advising that Hong Kong and the United States have substantially concluded discussions on the IGA and that it is expected to be signed later 2014. The Hong Kong SAR Government has also published a set of frequently asked questions (FAQs) providing background information regarding the IGA. The Hong Kong SAR Government has reminded financial institutions in Hong Kong to assess the implications of FATCA for their operations and clientele.

Click to read the respective SFC circular.

HKMA

- **Enhanced Competency Framework for Private Wealth Management ("PWM") Practitioners ("ECF")**

HKMA encourages Registered Institutions which operate as private banks or have dedicated private banking units (collectively "private banks") to adopt the ECF, which is being launched today as the benchmark for enhancing the level of core competence and on-going professional development of PWM practitioners. The ECF sets out an enhanced level of core competence and on-going professional development for PWM practitioners who undertake customer-facing roles. The ECF is a non-statutory framework separate from the existing licensing or registration regime for the securities industry.

In its Supervisory Policy Manual module CG-6 “Competence and Ethical Behaviour”, the HKMA emphasises the responsibility of an authorized institution’s Board of Directors and senior management in ensuring staff competence and ethical behaviour, including the adoption of appropriate policies and procedures to assess the competence of newly recruited staff; monitor and review the knowledge, skills and performance of individual staff members; provide relevant and timely training to ensure continuing competence of staff members; and address any identified failings or gaps in a timely fashion.

Click to read the respective HKMA circular.

- **New Supervisory Policy Manual (“SPM”) Module RE-1: Recovery Planning**

Following consultation with the two industry Associations, the Monetary Authority (“MA”) was issuing the above-mentioned SPM module as statutory guidance, by notice in the Gazette, under section 7(3) of the Banking Ordinance.

Recovery (as well as resolution) planning for financial institutions has recently been the subject of considerable international focus. The Financial Stability Board’s Key Attributes of Effective Resolution Regimes for Financial Institutions (“Key Attributes”), issued in November 2011, include standards relating to the development of recovery and resolution plans for, at a minimum, financial institutions that could be systemically significant or critical if they were to fail. In particular, Key Attribute 11 covers recovery and resolution planning, involving action by both financial institutions and regulatory authorities.

Click to read the respective HKMA circular.

- **Implementation of Basel III – Quarterly Template for Reporting of Leverage Ratio**

HKMA has finalized the Leverage Ratio reporting package for locally incorporated authorized institutions (AIs) to report their leverage positions to the Authority on a quarterly basis. The Basel III Leverage Ratio (“LR”) is defined as the Capital Measure (the numerator) divided by the Exposure Measure (the denominator), expressed as a percentage. In accordance with the implementation timeline of the Basel Committee on Banking Supervision (“BCBS”), the parallel run period for the LR commences on 1 January 2013 and continues until 1 January 2017. Public disclosure of the LR will start on 1 January 2015. During the parallel run period, a “testing minimum” LR of 3% has been set by the BCBS for the purpose of regulatory monitoring.

Click to read the respective HKMA circular.

- **Risks associated with virtual commodities**

In view of recent media reports about a number of entities that either operate or consider operating virtual commodity exchange in Hong Kong, HKMA issued a circular to reiterate the importance of prudently managing risks associated with virtual commodities, particularly the money laundering and terrorist financing risks. The HKMA expects AIs to

continue to exercise an escalated level of vigilance when they consider whether to establish or maintain business relationships with customers who are operators of schemes related to virtual commodities, taking into account whether such operators have established effective controls against the specific ML/TF risks involving virtual commodities.

The HKMA is aware that at the time the relationship is established, AIs may not have the full information of the business nature of a customer. A comprehensive risk profile may only become evident once the customer has begun transacting through an account, as indicated in paragraph 3.6 of the Guideline on Anti-Money Laundering and Counter-Terrorist Financing (“AML Guideline”). AIs should rely on existing anti-money laundering measures to address this risk, such as the continuous monitoring of customer transactions and ongoing review of customer risk profiles to keep them up-to-date and relevant.

Click to read the respective HKMA circular.

- **Basel Committee – New Large Exposures Framework**

The Basel Committee on Banking Supervision (BCBS) issued a new Supervisory framework for measuring and controlling large exposures (see <http://www.bis.org/publ/bcbs283.htm>) on 15 April 2014. The framework is scheduled to take effect from 1 January 2019 and it will supersede the BCBS large exposures guidance from 1991 which forms the basis of the current large exposures rules in many jurisdictions, including Hong Kong.

The new large exposure standard includes a general limit applied to all of a bank's exposures to a single counterparty, which is set at 25% of a bank's Tier 1 capital. This limit also applies to a bank's exposure to identified groups of connected counterparties (i.e. counterparties that are interdependent and likely to fail simultaneously). A tighter limit, set at 15% of Tier 1 capital, will apply to exposures between banks that have been designated as global systemically important banks (G-SIBs). The HKMA intends to implement the new standard in accordance with the BCBS timetable and will consult the industry on its implementation proposals for Hong Kong in due course. In the meantime, authorized institutions are strongly recommended to familiarise themselves with the new framework and to carefully consider the implications on their business activities.

Click to read the respective HKMA circular.

- **Control measures for guarding against some recent fraud cases**

HKMA published the above circular as a response to number of cases related to unauthorized fund transfers due to fraudulent email instructions. The circular is aimed at Authorizes Institutions (AIs) to ensure that appropriate and robust call back and client identification procedure are followed before client funds are transferred. The HKMA provided comprehensive list of controls related to transfer of clients' funds in order to minimize the risk of losing client money or assets as a result of poor client identification procedures.

Click to read the respective HKMA circular:

- **Issuance and implementation of a final standard for the capital treatment of bank exposures to central counterparties**

The Basel Committee on Banking Supervision (BCBS) issued on 10 April 2014 a standard on Capital requirements for bank exposures to central counterparties to replace the interim capital requirements for bank exposures to central counterparties (CCPs) published in June 2012. Scheduled to take effect on 1 January 2017 when the interim capital requirements will be replaced, the standard introduces a number of changes to simplify the underlying policy framework and to complement relevant initiatives undertaken by other supervisory bodies.

The HKMA's current intention is to implement the final standard (through amendment of the Banking (Capital) Rules) in accordance with the BCBS implementation timetable. The industry will be consulted on the implementation proposals in due course. Authorized institutions that engage in derivatives activities are strongly recommended to review and consider the relevant implications of the final standard.

Click to read the respective HKMA circular.

- **Implementation of new standardised approach for measuring counterparty credit risk exposures**

The Basel Committee on Banking Supervision (BCBS) issued on 31 March 2014 its final standard on The standardised approach for measuring counterparty credit risk exposures (see <http://www.bis.org/publ/bcbs279.pdf>) setting out a new non-modelled approach for measuring counterparty credit risk (CCR) exposures under the Basel capital adequacy framework. The new standardised approach (SA-CCR), which is applicable to exchange-traded derivatives, OTC derivatives and long settlement transactions, will replace the existing non-modelled CCR measurement approaches (i.e. the Current Exposure Method (CEM) and the Standardised Method) in the Basel capital adequacy framework. Compared with the existing non-modelled approaches, the SA-CCR is more risk-sensitive in that it has been calibrated to reflect volatilities observed in the recent stress period and provides more meaningful recognition of the effects of margining and netting, while also having regard to the need to ensure incentives for centralised clearing of derivatives. The SA-CCR is scheduled to take effect on 1 January 2017. The HKMA's current intention is to implement the SA-CCR in accordance with the BCBS implementation timetable.

Click to read the respective HKMA circular.

HKEx

- **Exchange Publishes Guidance Letter on its Reverse Takeover Rules**

The Stock Exchange of Hong Kong Limited (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), published a guidance letter on the application of the reverse takeover rules in its Listing Rules.

"We have conducted a number of reviews of the reverse takeover rules in recent years to improve the regulation of

reverse takeovers and certain significant acquisitions," said David Graham, HKEx's Chief Regulatory Officer and Head of Listing. "The guidance letter consolidates and reflects our current approach in applying the reverse takeover rules, which was endorsed by the Listing Committee and discussed in the 2009, 2010 and 2013 Listing Committee annual reports. It also provides guidance on the related administrative requirements, with a view towards facilitating the vetting of issuers' proposed transactions."

The guidance letter is available under the "Rules & Regulations – Rules and Guidance on Listing Matters – Guidance Letters – Guidance Letters for Listed Issuers" section of the HKEx website.

Click to read the respective HKEx news.

- **SEHK and HKSCC Issue Participants Circular on Shanghai-Hong Kong Stock Connect**

SEHK and HKSCC published circulars and related materials to their respective participants to provide information on the key features of Shanghai-Hong Kong Stock Connect. The circulars and related materials is that pending the signing of the formal agreement between the Parties with regard to the establishment of Shanghai-Hong Kong Stock Connect (which will be the subject of further announcement by HKEx in accordance with the Securities and Futures Ordinance and the Listing Rules of The Stock Exchange of Hong Kong Limited), the Parties have agreed, after having consulted the SFC and the CSRC, that further information on Shanghai-Hong Kong Stock Connect be provided by SEHK and HKSCC as the exchange and clearing house operators respectively, for the purpose of facilitating market understanding of the proposed arrangements and readiness for the implementation of the pilot programme.

Click to read the respective HKEx news.

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