

# FINANCIAL SERVICES COMPLIANCE

## Hong Kong



# Financial Services Compliance

Consulting editors

**Zachary J. Zweihorn**

*Davis Polk & Wardwell LLP*

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Quick reference guide enabling side-by-side comparison of local insights, including into the regulatory framework; registration and authorisation regimes; enforcement; compliance programmes; cross-border regulation and international standards; and other recent trends.

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### Hong Kong



**Karen Chan**

karen.chan@davispolk.com

*Davis Polk & Wardwell LLP*



**Joyce Chow**

joyce.chow@davispolk.com

*Davis Polk & Wardwell LLP*

**Davis Polk**

## REGULATORY FRAMEWORK

### Regulatory authorities

#### What national authorities regulate the provision of financial products and services?

The Hong Kong system of financial regulation reflects a modified institutional approach, with different regulators largely responsible for the oversight of different types of financial institutions.

The two principal authorities responsible for the regulation of banking, and securities and derivatives products and services are:

- the Hong Kong Monetary Authority (HKMA), which regulates banks; and
- the Securities and Futures Commission (SFC), which regulates securities, futures and other contract markets, as well as certain entities that participate in those markets.

There is, however, increasing overlap among and between regulators, particularly as banks expand the range of securities activities in which they are engaged.

*Law stated - 17 January 2022*

#### What activities does each national financial services authority regulate?

The HKMA oversees all aspects of authorised banking institutions within its jurisdiction, including banks, restricted licence banks (eg, merchant banks) and other deposit-taking companies. It supervises these authorised institutions on a consolidated basis, with the aim of promoting the safety and stability of the banking system, including in respect of local and overseas branches and subsidiaries. The principal areas of HKMA supervision include capital adequacy and liquidity, exposure concentration, resolution, and anti-money laundering and counter-financing of terrorism (AML/CFT) obligations (eg, customer due diligence), with different requirements applicable to locally and foreign-incorporated institutions.

The SFC is responsible for the licensing (or registration) and supervision of intermediaries and individuals – including broker-dealers, advisers and funds – engaged in a wide range of securities and futures activities, including:

- dealing in securities;
- dealing in futures contracts;
- leveraged foreign exchange trading;
- advising on securities;
- advising on futures contracts;
- advising on corporate finance;
- providing automated trading services;
- securities margin financing;
- asset management; and
- providing credit rating services.

The SFC is also responsible for overseeing market operators, including, among others:

- Hong Kong Exchanges and Clearing Limited, which operates:

- the Stock Exchange of Hong Kong (SEHK);
- the Hong Kong Futures Exchange;
- clearing houses; and
- alternative trading platforms (eg, dark pools);
- overseeing takeovers and mergers of listed companies; and
- the regulation of investment products (including, from April 2019, investment products offered by intermediaries via online platforms).

For example, the SFC and the SEHK work closely together in relation to tackling backdoor listings and shell activities. Backdoor listings involve transactions or arrangements (usually involving listed shell companies) that are structured to achieve a listing of assets while circumventing the requirements that apply to a new listing applicant. Problems with such listings have received widespread attention in Hong Kong.

Authorised banking institutions supervised by the HKMA must register with the SFC as to regulated securities activities undertaken in Hong Kong, but the HKMA is responsible for the day-to-day oversight of any such activities performed by these authorised institutions. The precise role and responsibilities of the HKMA in respect of the securities activities of authorised institutions are set out in a series of memoranda of understanding between the HKMA and the SFC. The Secretary for Financial Services also plays a coordinating role, and helps to set policy for the securities and futures markets generally.

*Law stated - 17 January 2022*

## What products does each national financial services authority regulate?

The HKMA exercises comprehensive supervisory oversight over all of the activities of authorised banking institutions, rather than regulating individual products.

The SFC regulates licensed (or registered) institutions on the basis of the activities in which they are engaged; for example, by imposing principles-based business conduct standards. These conduct standards are applicable to all licensed and registered institutions (and individual persons), and include expectations and requirements as to the suitability of products offered or sold to third-party customers.

Through its supervisory and rule-making authority over market operators, the SFC also regulates certain financial products, including securities and futures. It thus has indirect authority over the manner in which these products are transacted; for instance, on exchange or over the counter. In addition, the SFC directly authorises and regulates investment products, including, among others:

- closed-end funds;
- exchange-traded funds;
- leveraged and inverse products;
- pooled retirement funds;
- unit trusts and mutual funds;
- structured investment products;
- real estate investment trusts;
- unlisted shares and debentures; and
- open-ended fund companies.

*Law stated - 17 January 2022*

## Authorisation regime

What is the registration or authorisation regime applicable to financial services firms and authorised individuals associated with those firms? When is registration or authorisation necessary, and how is it effected?

As to securities and futures activity, financial services firms must be licensed by the SFC before engaging in any of the regulated activities, subject to narrow statutory exemptions. Licensing is necessary when financial services firms carry out a regulated activity, as well as when they hold themselves out as doing so. A licence must be obtained (or a relevant exemption identified) for each type of regulated activity that the financial services firm intends to undertake.

Licensing is also necessary if a financial services firm actively markets to the public in Hong Kong any service that would be a regulated activity if performed in Hong Kong. This is true whether the firm is marketing its services from Hong Kong or overseas, including when it does so through a third party. For instance, a US-based asset manager soliciting clients for its US-based services in Hong Kong would need to be licensed for asset management activity in Hong Kong, even if the solicitation was undertaken through its Hong Kong-licensed subsidiary.

Individuals must also be licensed before performing a regulated activity on behalf of their licensed corporation. In addition, any executive directors (ie, senior managers) supervising a licensed corporation's regulated activities must also be licensed as 'responsible officers'.

Temporary licences are available to both firms and individuals if they are to undertake regulated activity only on a short-term basis and it is the SFC's expectation that such licences will be obtained before any regulated activity is undertaken, even in the case of a day-long business meeting in Hong Kong, for instance.

To receive a licence, a firm or individual must apply to the SFC. Different requirements apply to each type of regulated activity, but at minimum, the application process ordinarily requires the submission of extensive materials, including detailed business plans; biographies of senior employees, directors and officers; and other corporate and individual records. All licensed persons – firms or individuals – must also, at minimum, demonstrate that they are 'fit and proper', in connection with which the SFC evaluates the applicant's financial status, qualifications, competence, honesty, fairness, reputation and character. Licensed firms must also comply with additional requirements, including financial resources rules (eg, rules relating to minimum paid-up share capital and liquid capital) and insurance rules. The application process for temporary licences is less complex, especially for individuals.

Banking organisations are also subject to authorisation requirements, albeit overseen by the HKMA rather than the SFC. Authorisation is required when banking activities are undertaken in Hong Kong and also when they are marketed to customers in Hong Kong. Hong Kong has a three-tier banking system that includes banks, restricted licence banks and deposit-taking companies. Different regulations, including different authorisation requirements, apply to locally incorporated banking organisations than to the Hong Kong branches of overseas banks. Otherwise, the application requirements are similar to those applicable to financial services firms licensed by the SFC, and banking entities seeking to engage in securities and futures activities in Hong Kong must also be licensed by the SFC.

The HKMA has also issued licences to virtual banks (ie, banks that deliver retail banking services primarily, if not entirely, through the internet or other electronic channels rather than physical branches). As at 31 December 2021, there are a total of eight virtual banks licensed by the HKMA. Virtual banks are subject to the same set of supervisory principles and key requirements as conventional banks, although some of the requirements may be adapted to suit this new business model.

*Law stated - 17 January 2022*

## Legislation

### What statute or other legal basis is the source of each regulatory authority's jurisdiction?

The importance of financial services to Hong Kong as an international financial centre is recognised in its Basic Law, which also gives the government the authority to 'formulate monetary and financial policies, safeguard the free operation of financial business and financial markets, and regulate and supervise them in accordance with the law'.

Otherwise, the jurisdiction of both the HKMA and the SFC is proscribed by statute: the Banking Ordinance (Cap 155) in the case of the HKMA, and the Securities and Futures Ordinance (Cap 571) (SFO) in the case of the SFC.

These ordinances set out the supervisory, examination and enforcement powers of the HKMA and SFC, respectively, in addition to conferring upon each regulator the authority to promulgate more particularised subsidiary legislation (ie, rule-making with the force of law) and non-binding guidance in respect of defined topics (eg, product suitability).

In relation to AML/CFT, the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615) (AMLO) sets out the statutory requirements relating to customer due diligence and record-keeping for specified financial institutions and the powers of the relevant authorities (including the HKMA and SFC) to supervise financial institutions' compliance with the requirements.

*Law stated - 17 January 2022*

### What principal laws and financial service authority rules apply to the activities of financial services firms and their associated persons?

#### HKMA

The principal statute applicable to institutions authorised by the HKMA is the Banking Ordinance (Cap 155).

The Banking Ordinance sets out the requirements for authorisation of financial services firms seeking to provide banking services; the HKMA's powers of direction and examination; restrictions on the ownership and management of authorised institutions; and liquidity and capital requirements, among others. It also authorises the promulgation by the HKMA of subsidiary legislation addressing a range of topics, from capital and liquidity requirements to disclosure rules, in more detail.

In addition to the Banking Ordinance and associated subsidiary legislation, institutions authorised by the HKMA must also comply with the minimum expectations and standards set out in the HKMA's Supervisory Policy Manual. The Supervisory Policy Manual codifies the HKMA's supervisory policies and practices, some of which reflect requirements under the Banking Ordinance or the AMLO, while others reflect industry best practices. Among the regulatory topics it addresses are corporate governance; internal controls; capital adequacy; credit, interest rate, operational and liquidity risk management; securities activities; and AML/CFT.

#### SFC

The principal statute applicable to entities and persons licensed or regulated by the SFC is the SFO. The SFO sets out the licensing requirements for entities that conduct regulated activity in Hong Kong; record-keeping, reporting and disclosure requirements; and civil, criminal and disciplinary enforcement regimes in respect of market misconduct. The SFO also confers upon the SFC the authority to promulgate subsidiary legislation addressing a wide range of topics including the treatment of client monies and securities; professional investors; short positions; contract limits; price stabilisation; and investor compensation.

In the case of both the HKMA and the SFC, the regulatory requirements reflected in statutes, subsidiary legislation and other binding policy statements are supplemented by a variety of codes of conduct, guidelines and circulars with varying degrees of legal effectiveness.

*Law stated - 17 January 2022*

### **Scope of regulation**

What are the main areas of regulation for each type of regulated financial services provider and product?

Institutions authorised by the HKMA are supervised on a consolidated basis. The main areas of regulation and supervision are registration; safety and soundness; capital and liquidity; internal controls and governance; business conduct; risk management (including AML/CFT); record-keeping; and reporting and disclosure. Pursuant to a memorandum of understanding between the HKMA and the SFC, the HKMA is also responsible for supervising the securities activities of HKMA-authorised institutions on a day-to-day basis, with the SFC principally responsible for enforcement action in respect of misconduct arising from such activities.

The SFC, unlike the HKMA, only regulates certain defined securities and futures activities as set out under the SFO. In respect of these activities, it regulates, inter alia, licensing requirements; business conduct (ie, the standard of care afforded customers); market conduct; internal controls, governance and supervision (including AML/CFT); the treatment of client securities and monies; record-keeping, reporting and disclosure obligations; the timing and format of contract notes; and various activity restrictions.

*Law stated - 17 January 2022*

### **Additional requirements**

What additional requirements apply to financial services firms and authorised persons, such as those imposed by self-regulatory bodies, designated professional bodies or other financial services organisations?

The SFC is responsible for licensing market operators, most notably the SEHK, the Hong Kong Futures Exchange and their associated clearing entities. These market operators act as self-regulatory bodies, but also as frontline regulators. Any person seeking to trade or clear through their facilities must comply with the policies, rules and procedures promulgated by each operator (and approved by the SFC). In the case of the SEHK, for instance, these rules govern admissible order types and sizes; trading hours; closing mechanisms; trade reporting; trading misconduct; maximum allowable position and lot sizes; the trading engine; and short selling restrictions, among other topics. Importantly, the SEHK is also the frontline regulator in respect of listing and listing applications.

*Law stated - 17 January 2022*

## **ENFORCEMENT**

### **Investigatory powers**

What powers do national financial services authorities have to examine and investigate compliance? What enforcement powers do they have for compliance breaches? How is compliance examined and enforced in practice?

Both the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) have the power to conduct on-site inspections and examinations of the financial services firms that they regulate, and to compel the production of certain documents. Both regulators also conduct off-site surveillance – the HKMA of the financial condition of the institutions it authorises, and the SFC of market conditions and trading activity.

In connection with these powers of inspection and surveillance, both regulators are also given the authority to conduct investigations, which can lead to disciplinary, civil or criminal enforcement actions.

*Law stated - 17 January 2022*

## Disciplinary powers

What are the powers of national financial services authorities to discipline or punish infractions?  
Which other bodies are responsible for criminal enforcement relating to compliance violations?

Both the HKMA and the SFC are authorised to take disciplinary or civil enforcement action (subject to the approval of the Department of Justice) in connection with regulatory breaches. A wide range of sanctions is available even in the disciplinary context, including licence revocation or suspension, fines and public reprimands, among others. In many cases, the HKMA and the SFC also require the entities or persons responsible for regulatory violations to strengthen and enhance internal controls and governance. In the civil context, the SFC can also petition the court for winding-up or bankruptcy orders; restoration orders; declarations that securities transactions are void; or for receivership. In addition, the courts and relevant tribunals can require disgorgement, impose financial penalties, and enforce activity restrictions and prohibitions on future conduct.

The HKMA and the SFC can also seek criminal prosecution in connection with certain regulatory breaches. The SFC can prosecute 'summary offences' on its own but must refer any indictable offences to the Department of Justice. The HKMA must refer all potential offences to the Department of Justice for prosecution.

The Stock Exchange of Hong Kong (SEHK) also has powers to discipline listed companies and their directors or senior management. In July 2021, amendments to the SEHK's disciplinary and sanctions powers came into effect, representing the first major update to the SEHK's disciplinary powers since 1993. These amendments increased the range of sanctions that the SEHK can impose, including the issuance of a public statement that the retention of office by a director is prejudicial to the interests of investors and the issuance of a Director Unsuitability Statement, which states that an individual is unsuitable to be a director or senior management member of the named listed issuer due to serious or repeated failure to discharge his or her duties. The amendments have also enabled disciplinary action to be brought against a wider range of individuals by imposing secondary liability on senior management for breaches of the Listing Rules in the case of a knowing breach and expanding the disciplinary regime to new parties, such as guarantors of debt securities and structured products.

Following the entry into a memorandum of understanding between the Independent Commission Against Corruption (ICAC) and the SFC in August 2019, the SFC and the ICAC conducted their first joint operations in July and August 2021. These operations resulted in the arrest of a number of listed company directors and senior management members for suspected corruption and market manipulation. It is expected that joint operations between the SFC and the ICAC – and other regulatory agencies – will become more common.

*Law stated - 17 January 2022*

## Tribunals

What tribunals adjudicate financial services criminal and civil infractions?

Hong Kong has a number of specialised tribunals responsible for the adjudication of disciplinary and civil infractions in

the financial services industry. In most cases, the regulatory authorities are also able to pursue civil enforcement actions in the Hong Kong courts.

SFC disciplinary decisions, for instance, are subject to appeal to the Securities and Futures Appeals Tribunal, where a full de novo review of the disciplinary proceedings is conducted by a three-member panel consisting of a chairman and two lay members. Final orders entered by the Securities and Futures Appeals Tribunal can be registered in or appealed to the Hong Kong courts.

Similarly, civil breaches of market misconduct provisions are heard by the Market Misconduct Tribunal, a three-member panel (one judge and two lay members) on which the SFC acts as the presenting officer. This tribunal can issue injunctions, order disgorgement or impose a prohibition on dealing in securities, taking management roles in listed companies, or engaging in future misconduct. Subsequent violations of its orders are punishable by imprisonment and fines.

Otherwise, civil actions are dealt with by the Hong Kong courts.

*Law stated - 17 January 2022*

## Penalties

What are typical sanctions imposed against firms and individuals for violations? Are settlements common?

In the disciplinary setting, the most common sanctions are fines (ordinarily three times the profit earned or loss avoided), public reprimands or partial licence suspensions, or all three. Penalties can range from incidental amounts to well over HK\$400 million, depending on the severity and scope of the relevant violations. Settlement of disciplinary actions is relatively common, but the regulators nearly always require some form of public reprimand.

For civil enforcement actions, the full range of economic and equitable sanctions are available, with disgorgement and prohibitions on future activity (eg, acting as the director of a listed company) being particularly common. Settlements of civil actions are also quite common, although statistics as to the rate of settlement are not publicly available.

*Law stated - 17 January 2022*

## COMPLIANCE PROGRAMMES

### Programme requirements

What requirements exist concerning the nature and content of compliance and supervisory programmes for each type of regulated entity?

For financial services firms engaged in securities and futures activity, the Securities and Future Commission (SFC) Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the SFC Code of Conduct) enshrines compliance as one of its nine general principles. The SFC Code of Conduct sets out numerous principles-based requirements in respect of internal controls; IT infrastructure and trading systems; the disclosure of firm financials; the handling of client assets; and compliance obligations. Other relevant subsidiary rules and regulations include:

- the Securities and Futures (Accounts and Audit) Rules;
- the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism; and
- the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC.

The HKMA's Supervisory Policy Manual also sets out detailed guidance as to the compliance programmes expected of

authorised banking institutions, the principal focus of which is risk management. The Supervisory Policy Manual also includes a Code of Conduct, which sets out the standards of business conduct and competence expected of authorised institutions and their employees.

*Law stated - 17 January 2022*

## Gatekeepers

### How important are gatekeepers in the regulatory structure?

Gatekeepers perform crucial functions within Hong Kong financial services firms. For firms engaged in regulated securities and futures activities, the role of gatekeepers is governed by the Securities and Futures Ordinance (Cap 571) (SFO) and its subsidiary rules, as well as regulations, codes and guidelines issued by the SFC. Under the SFO, licensed corporations in Hong Kong must have at least one 'responsible officer' for each regulated activity that they are licensed to conduct. As recent cases have shown, responsible officers of licensed corporations are expected to actively supervise the functions that they oversee and to bear primary responsibility for compliance, including potentially being subject to disciplinary penalties for compliance failures. This expectation is also codified in the SFC Code of Conduct applicable to all licensed entities.

Licensed corporations are also subject to the manager-in-charge (MIC) regime, which aims to more clearly define who should be regarded as senior management of licensed corporations and enhance individual accountability. The SFC has identified eight core functions of licensed corporations and requires licensed corporations to designate an MIC for each. Among the core functions are compliance (including the chief compliance officer); anti-money laundering and counter-financing of terrorism; finance and accounting; risk management; and operational control and review (including the head of the internal audit). The MIC overseeing these gatekeeping functions are subject to the SFC's disciplinary powers, even if they are not themselves licensed persons. This means that traditional compliance, back-office and middle-office functions are brought within the scope of the SFC's authority.

These requirements also apply to banking organisations that are authorised by the HKMA but are registered with the SFC to conduct securities and futures activities. Otherwise, the HKMA takes a more traditional approach to the role of gatekeepers and corporate governance, largely relying on directors and senior officers to manage risk and ensure compliance. The HKMA's Supervisory Policy Manual does, however, set out detailed and extensive guidance as to the role of the internal audit function, including the expectation that authorised institutions will, in most cases, have an audit committee and that the internal audit function will reflect the size, scope and complexity of an authorised institution's business and operations. With respect to risk management and compliance, it is expected that there will be separate, designated risk and compliance officers, with the board of directors principally responsible for ensuring that these functions are adequately resourced.

*Law stated - 17 January 2022*

## Directors' duties and liability

### What are the duties of directors, and what standard of care applies to the boards of directors of financial services firms?

Common law directors' duties apply to the boards of directors of financial services firms in Hong Kong. These include the duties to:

- act in good faith for the benefit of the company as a whole;
- exercise power solely for proper purposes;

- exercise independent judgement and refrain from delegation without proper authorisation;
- exercise care, skill and diligence;
- avoid conflicts of interest or abuses of position;
- avoid unauthorised use of firm property or information; and
- maintain proper accounting records.

The statutory standard of care applicable to directors is set out in the Companies Ordinance (Cap 622) . This statute expressly displaces the common law standard of care. In determining whether a director has breached his or her duties, courts in Hong Kong will apply a mixed subjective and objective test, comparing the conduct of the director to that of a 'reasonably diligent person' who has the general knowledge, skill and experience reasonably expected of a person in the director's position (the objective component) and the knowledge, skill and experience that the specific director actually possesses (the subjective component).

Generally, directors of financial services firms should also bear in mind the need for management to instil a strong compliance tone from the top. This is especially important in light of a heightened regulatory focus on individual and senior management accountability. In May 2017, the SFC published a reminder of steps that directors may take to minimise the risk of corporate misconduct and promote a culture of good corporate governance.

In December 2021, the Stock Exchange of Hong Kong (SEHK) announced revisions to the Corporate Governance Code and its related Listing Rules (effective as of 1 January 2022). The amendments included provisions on corporate culture, board independence and refreshment. The SEHK also published a new Corporate Governance Guide for Boards and Directors , which sets out the key functions of an effective board, and provides guidance to executive, non-executive and prospective directors on the nature of their roles and responsibilities.

*Law stated - 17 January 2022*

## When are directors typically held individually accountable for the activities of financial services firms?

Directors may be held individually accountable for the activities of financial services firms as a result of regulatory breaches. For instance, the SFO empowers the SFC to seek injunctive relief and other orders on behalf of investors against persons who contravene – or aid, abet, induce or are involved in the contravention of – any provision of the SFO. The SFO also authorises civil actions against directors who fail to take reasonable measures to establish safeguards against market misconduct. Directors of licensed corporations who are also responsible officers or MICs are also subject to the SFC's disciplinary powers if found liable for the misconduct of financial services firms.

Recent enforcement cases reflect Hong Kong's regulatory focus on director and senior management accountability for the activities of financial services firms, with the SFC bringing civil proceedings against individual directors for, among other things, failing to act in a company's best interests in connection with the late disclosure of inside information. In November 2021, the SFC announced its first disciplinary action against an individual MIC since the implementation of the MIC regime in 2017.

The year 2021 saw a continued disciplinary focus by Hong Kong financial regulators on ensuring the personal accountability of individuals working in the financial services industry. This was reflected in the SEHK's updated policy statement on the enforcement of the Listing Rules, highlighting as one of its key priorities the accountability of individuals that are responsible for discharging duties in connection with listing matters. The HKMA also took action in this area by proposing, in May 2021, a mandatory reference checking scheme that aims to prevent individuals who were formerly engaged in misconduct at one financial services employer from repeating their misconduct at a new financial services employer.

## Private rights of action

Do private rights of action apply to violations of national financial services authority rules and regulations?

Private rights of actions for regulatory violations are available in only very limited circumstances. Such actions would be relevant for individuals who suffer pecuniary loss as a result of another person committing the market misconduct offences set out in the SFO. These offences include:

- insider dealing;
- false trading;
- price rigging;
- disclosure of information about prohibited transactions;
- disclosure of false or misleading information inducing transactions; and
- stock market manipulation.

They also include the offences of:

- use of fraudulent or deceptive devices in securities, futures contracts or leveraged foreign exchange trading;
- disclosure of false or misleading information inducing transactions in leveraged foreign exchange trading; and
- falsely representing dealings in futures contracts on behalf of others.

Persons found liable in connection with private rights of action brought pursuant to these provisions are required to pay damages if it is fair, just and reasonable in the circumstances. Courts may also impose injunctive relief in addition to or in lieu of orders for damages. Potential defendants under these provisions are not limited to persons directly perpetrating a market misconduct offence. Investors also may seek to recover from persons who knowingly assist or connive with others in the perpetration of market misconduct. Officers of corporations also may be named as defendants if market misconduct was perpetrated by the corporation with the officer's consent or connivance. 'Officers' is widely defined in the SFO as directors, managers, secretaries and any other person involved in the management of a corporation are all deemed 'officers of a corporation'.

## Standard of care for customers

What is the standard of care that applies to each type of financial services firm and authorised person when dealing with retail customers?

In Hong Kong, the relationship between retail customers and financial institutions is principally a matter of contract, as applied within the context of the common law duties of banks.

In addition, financial services firms licensed or regulated by the SFC must, as a condition of their licences, meet minimum, principles-based regulatory standards governing the treatment of customers which are principally set out in the SFC Code of Conduct. The SFC Code of Conduct requires licensed entities to:

- act honestly, fairly and diligently, and in the best interests of their clients;
- obtain adequate information about the financial situation, investment experience and objectives of clients;
- make adequate disclosures of relevant information to clients; and
- properly account for and safeguard client assets.

The SFC Code of Conduct also elaborates more particularised minimum requirements in respect of, among other things, the content of client agreements and the principles of prompt and best execution.

Banks authorised by the HKMA are expected to comply with the recommended practices prescribed in the Code of Banking Practice, which was promulgated by industry associations but endorsed by the HKMA. The Code of Banking Practice, although not binding or a condition of authorisation, sets out similar, albeit more particularised expectations for the treatment of banking customers. These are organised by reference to specific banking activities, including account management, card services, payment services and electronic banking services. These expectations reflect a set of general principles announced in the Code of Banking Practice, among which is the equitable and fair treatment of customers, with special attention given to the needs of vulnerable groups. The Code of Banking Practice was amended in December 2021 to reflect expectations with regard to digital banking services (including promotions on social media).

*Law stated - 17 January 2022*

### Does the standard of care differ based on the sophistication of the customer or counterparty?

In respect of securities and futures activity, including when such activity is performed by banks, the standard of care owed to customers varies based on the sophistication of the customer (ie, their net worth and investment experience).

Under the SFO and related guidance promulgated by the SFC, certain customers may be classified as professional investors. In such cases, certain regulatory requirements are relaxed, including those pertaining to obtaining information about a customer's financial condition, experience and objectives; the minimum contents of client agreements; the suitability of investment products; and the type of transaction-related information that must be disclosed to clients.

The HKMA also recognises certain categories of customers (eg, private banking customers) for which suitability and other requirements are reduced. In respect of banking activity, however, the standard of care does not vary based on customer sophistication, aside from the expectation elaborated in the Code of Banking Practice that banks should devote special attention to vulnerable populations (eg, the elderly).

*Law stated - 17 January 2022*

### Rule-making

#### How are rules that affect the financial services industry adopted? Is there a consultation process?

With certain exceptions, all subsidiary legislation in Hong Kong must ordinarily go through a process of consultation prior to adoption. This is true for subsidiary legislation adopted by both the SFC and the HKMA (in some cases, the regulatory bodies are also required to consult with each other). Subsidiary legislation refers to those rules and guidelines promulgated pursuant to express authority in the relevant governing statutes (ie, the SFO and the Banking Ordinance (Cap 155)).

The consultation process for subsidiary legislation involves the circulation of proposed rules for public consideration, the opportunity for public comment, the circulation of consultation conclusions setting out any public comments

received, regulator responses to these comments (as well as any new amendments that substantively differ from the original draft) and publication of the final rules for adoption.

Both the HKMA and the SFC also regularly publish circulars and other guidance in which they set out their interpretations of requirements set out in statute or subsidiary legislation. No consultation is ordinarily undertaken in connection with such interpretive guidance as it does not have the force of law.

*Law stated - 17 January 2022*

## **CROSS-BORDER ISSUES**

### **Cross-border regulation**

#### **How do national financial services authorities approach cross-border issues?**

Hong Kong largely takes a territorial approach to the regulation of its securities and futures markets. Financial services firms must be licensed by the Securities and Futures Commission (SFC) to conduct regulated securities and futures activities whenever they conduct those activities in Hong Kong, as well as when they actively market to the public in Hong Kong any service that, if performed in Hong Kong, would be a regulated activity. This is true whether the firm is marketing its services from Hong Kong or abroad, including when it does so through a third party (eg, a subsidiary or affiliate). Even when such a regulated activity, or the marketing of such a regulated activity, is conducted in Hong Kong on a temporary or short-term basis only (eg, a one-off meeting with a brokerage client), a temporary licence is required.

Banking organisations authorised in Hong Kong are also subject to regulation in respect of their overseas activity, including the powers of inspection of the Hong Kong Monetary Authority (HKMA). Authorised institutions cannot open overseas branches (or acquire overseas banks) without the approval of the HKMA, and must regularly disclose to the HKMA the assets and liabilities of their overseas entities. The HKMA frequently communicates with its overseas counterparts and can disclose information about the operations of institutions authorised in Hong Kong to overseas regulators, provided that there are adequate privacy measures in place. The HKMA also looks to the home regulators of banking organisations incorporated overseas in determining whether to authorise them to conduct banking activity in Hong Kong. Such organisations can only be authorised in Hong Kong if the HKMA is satisfied that they are adequately supervised by their home banking regulator. Without authorisation, overseas banks cannot engage in any banking business, although they can open local representative offices to liaise with local customers.

The SFC and the HKMA also both cooperate extensively with international regulators, especially regulators in mainland China.

For example, the SFC and the China Securities Regulatory Commission (CSRC) hold regular meetings to discuss a range of matters concerning cross-boundary enforcement cooperation. In November 2021, the SFC and the CSRC jointly held an online training session to share their experiences of investigations into intermediary misconduct, fraud and disclosure offences by listed companies, and market manipulation.

The HKMA has signed memoranda of understanding with the China Banking and Insurance Regulatory Commission to enhance the exchange of supervisory information and cooperation, in addition to various other collaborative initiatives with the People's Bank of China, including those relating to mutual bond market access between Hong Kong and mainland China (Bond Connect).

The SFC has memoranda of understanding with Switzerland, the United States, Singapore and Japan to facilitate varying degrees of mutual assistance on a cross-border basis and frequently makes or receives requests for assistance from regulators globally. The HKMA has similar cooperative arrangements with foreign jurisdictions, including with Australia, Canada, mainland China, France, Germany, India, Japan, the United Kingdom and the United States.

One potential exception to this territorial approach is the catch-all fraud provision of the SFO, modelled on Rule 10b-5 of

the US Securities and Exchange Act of 1934, which the SFC has previously used to target insider dealing in Taiwan in securities listed on the Taiwan Stock Exchange. Importantly, significant elements of the fraudulent scheme were devised in Hong Kong, but this enforcement action nevertheless shows that the SFC will use its ostensibly territorial jurisdiction to reach conduct that principally occurs offshore, especially where it impacts Hong Kong's markets and market participants.

*Law stated - 17 January 2022*

## International standards

What role does international standard setting play in the rules and standards implemented in your jurisdiction?

Both the HKMA and the SFC are active participants in the Financial Stability Board (FSB), an international body that monitors and makes recommendations about the global financial system with a view to reducing vulnerability and safeguarding the smooth functioning of financial markets through enhanced information exchange and cooperation in financial supervision and surveillance. Hong Kong's inclusion in the FSB is a recognition of its status as a systemically important financial centre.

In July 2019, the HKMA implemented the Banking (Exposure Limits) Rules, which aim to implement the Basel Committee's large exposures standards. With regard to other Basel III reforms, the HKMA announced in June 2021 that it expects the revised frameworks on credit risk, operational risk, output floor, leverage ratio, market risk and credit valuation adjustment risk to be revised by July 2023.

In the anti-money laundering and counter-financing of terrorism (AML/CFT) sector, the SFC and the HKMA both work to ensure that the international standards and guidance promulgated by the Financial Action Task Force (FATF) are adequately reflected in Hong Kong's AML/CFT framework. In September 2019, the FATF released the Mutual Evaluation Report of Hong Kong (the FATF Report), which assessed Hong Kong's AML/CFT regime as being compliant and effective overall (scoring in the top 25 per cent of FATF members globally). The FATF Report made a number of recommendations for how Hong Kong could improve its AML/CFT framework. In September 2021, the SFC reflected some of these suggestions in amendments to its Guideline on Anti-Money Laundering and Counter-Financing of Terrorism, including amendments relating to cross-border correspondent relationships, third-party deposits and payments, and institutional and customer risk assessments.

*Law stated - 17 January 2022*

## UPDATE AND TRENDS

### Key developments of the past year

Are there any other current developments or emerging trends that should be noted?

### Virtual assets and cryptoassets

With regard to the authorisation and regulation of virtual assets (eg, digital currencies, cryptoassets, etc) and the platforms on which they are traded (ie, virtual asset services platforms (VASPs)), in May 2021 the government announced a proposed licensing regime for VASPs. This new framework would be implemented through amendments to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615). Under the proposals, all VASPs operating in Hong Kong as a virtual assets exchange (not including peer-to-peer trading platforms) would be required to apply for a licence from the Securities and Futures Commission (SFC). The proposed definition of 'virtual assets' would likely include cryptocurrencies and virtual coins that are backed by another asset, irrespective of the purported form of

the underlying assets. The proposed licensing regime would subject applicants and licensees to a fit and properness test. It is expected that the legislation reflecting these amendments will be introduced in 2022. The expected introduction of a mandatory licensing regime marks a shift from the current, more permissive 'opt-in' regulatory stance announced by the SFC in 2019, under which VASPs operating in Hong Kong voluntarily opt in to regulation by applying for a licence. As at 31 December 2021, the SFC has only granted one licence to a VASP under the current framework.

The Hong Kong Monetary Authority (HKMA) has also been active in evaluating how to approach virtual assets and cryptoassets. In January 2022, the HKMA released its Discussion Paper on Crypto-assets and Stablecoins, which provided details about the factors that the HKMA is considering as it develops its proposed regulatory approach on cryptoassets and invited stakeholders to submit comments. The discussion paper, which has a wider scope than the SFC's focus on VASPs, identified two areas for deliberation:

- the HKMA's regulatory approach regarding banks' interface with and provision of intermediary services related to cryptoassets to customers; and
- the adequacy of the existing regulatory framework in response to the challenges that arise from the growing use of stablecoins and other types of cryptoassets in financial markets.

In line with international standards, the HKMA announced that it will adopt a risk-based, 'same risk, same regulation' approach to the regulation of crypto entities and activities. Comments are due at the end of March 2022 and the new regulatory regime is expected to be in place by 2023 or 2024.

#### Climate

Climate risks and sustainability in the financial sector were areas of regulatory focus in 2021. A few of the initiatives are set out below.

- The HKMA issued a draft guideline in July 2021 on climate risk management for consultation with the banking industry. The guideline, which further develops the HKMA's approach to climate risk initially outlined in June 2020 in its White Paper on Green and Sustainable Banking, would impose regulatory expectations on all locally incorporated banks in line with leading international standards and practices. International banking groups operating in the city will also be expected to have a framework in place for addressing climate-related issues.
- The SFC issued amendments in August 2021 to the Fund Manager Code of Conduct. The amendments generally seek to implement the Task Force on Climate-related Financial Disclosures (TCFD) Recommendations for Hong Kong's fund management sector. The new requirements will be implemented in phases, with the first phase due to begin on 20 August 2022.
- In November 2021, Hong Kong Exchanges and Clearing Limited (HKEx) published guidance to listed issuers on climate disclosures (incorporating the TCFD Recommendations), as well as an analysis of initial public offering (IPO) applicants' corporate governance and environmental, social and governance practice disclosure in 2020–2021.

#### IPO-related misconduct

The SFC, working closely with the HKEx, also continued its recent focus on listed companies over the past year. In May 2021, the SFC and the HKEx issued a joint statement on IPO-related misconduct, setting out their general approach to tackling regulatory issues in recent new listings, including market manipulation by means of ramp and dump schemes. The SFC issued a circular in June 2021 to licensed corporations that asked them to notify the SFC of suspected ramp and dump schemes. The circular also provided guidance on red flags that may arouse reasonable suspicion of such

schemes. In November 2021, in a move thought to be linked to the May 2021 joint statement, for the first time since 2009 the SFC and the Stock Exchange of Hong Kong (SEHK) requested that a listing applicant disclose in its prospectus the listing conditions imposed by the SFC. The disclosures required include information related to broker fees, IPO pricing, share allocation and monthly updates for a year on how the proceeds are being spent.

### Markets

In August 2021, the SFC announced that it would implement an investor identification regime at the trading level for the securities market in Hong Kong in 2022. The changes are intended to close disclosure and identification loopholes used by retail investors to gain an unfair advantage in their bids for stock allotments. The SFC also introduced an over-the-counter (OTC) securities transactions reporting regime for SEHK-listed shares, due to come into effect in 2023. The new reporting requirement for OTC transactions was proposed after the SFC found that OTC securities transactions have been used in many manipulation schemes investigated by the regulator.

In October 2021, the SFC published its consultation conclusions on a proposed code of conduct on book-building and placing activities in equity capital market and debt capital market transactions. The new code, which will come into effect in August 2022, clarifies the roles played by intermediaries in equity and debt capital raisings, and sets out the standards of conduct expected of them in book-building, pricing, allocation and placing activities.

Also in October 2021, the SFC and the HKMA announced the results of a joint thematic review of intermediaries' spread charges and related practices, as well as disclosure of transaction-related information. The resulting report covers treatment and disclosure of price improvements, spread charges and pricing arrangements, disclosure of transaction-related information, and expected standards of conduct.

*Law stated - 17 January 2022*

## Jurisdictions

	<b>Australia</b>	Herbert Smith Freehills LLP
	<b>Brazil</b>	Pinheiro Neto Advogados
	<b>Egypt</b>	Soliman, Hashish & Partners
	<b>Hong Kong</b>	Davis Polk & Wardwell LLP
	<b>Indonesia</b>	ABNR
	<b>Ireland</b>	Dillon Eustace LLP
	<b>Japan</b>	Anderson Mōri & Tomotsune
	<b>Luxembourg</b>	AKD
	<b>Netherlands</b>	Baker McKenzie
	<b>Russia</b>	EMPP
	<b>Switzerland</b>	Lenz & Staehelin
	<b>United Kingdom</b>	Davis Polk & Wardwell LLP
	<b>USA</b>	Davis Polk & Wardwell LLP