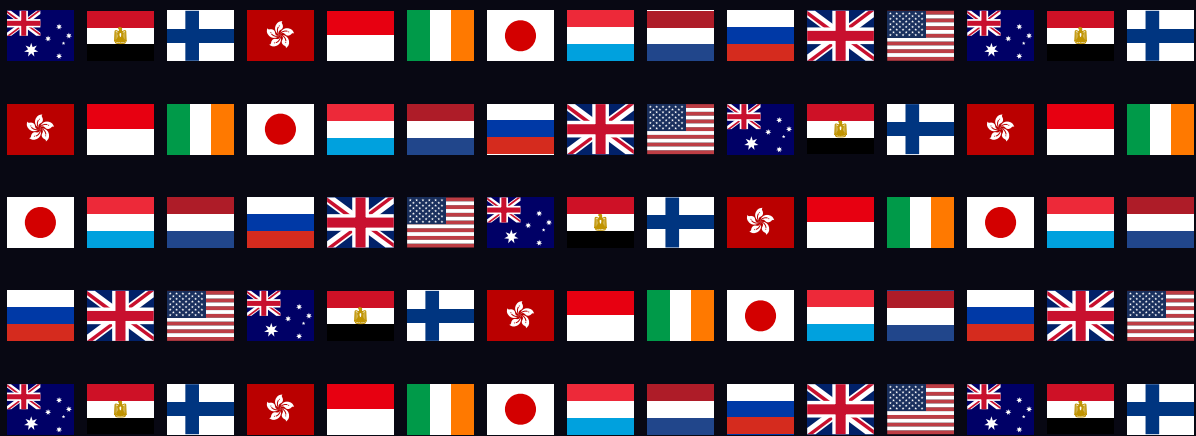


# FINANCIAL SERVICES COMPLIANCE

## Hong Kong



# Financial Services Compliance

Consulting editors

**Zachary J. Zweihorn**

*Davis Polk & Wardwell LLP*

---

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.

---

Generated 08 March 2023

The information contained in this report is indicative only. Law Business Research is not responsible for any actions (or lack thereof) taken as a result of relying on or in any way using information contained in this report and in no event shall be liable for any damages resulting from reliance on or use of this information. © Copyright 2006 - 2023 Law Business Research

# Table of contents

## REGULATORY FRAMEWORK

Regulatory authorities  
Authorisation regime  
Legislation  
Scope of regulation  
Additional requirements

## ENFORCEMENT

Investigatory powers  
Disciplinary powers  
Tribunals  
Penalties

## COMPLIANCE PROGRAMMES

Programme requirements  
Gatekeepers  
Directors' duties and liability  
Private rights of action  
Standard of care for customers  
Rule-making

## CROSS-BORDER ISSUES

Cross-border regulation  
International standards

## UPDATE AND TRENDS

Key developments of the past year

## Contributors

### Hong Kong



**Martin Rogers**  
martin.rogers@davispolk.com  
*Davis Polk & Wardwell LLP*



**Bo Huang**  
bo.huang@davispolk.com  
*Davis Polk & Wardwell LLP*



**Joyce Chow**  
joyce.chow@davispolk.com  
*Davis Polk & Wardwell LLP*



**Leanne Chu**  
leanne.chu@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 has a modified institutional approach, with a range of regulators.

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 intermediaries that participate in those markets.

The HKMA and the SFC operate MOUs to deal with their overlapping jurisdiction. The Insurance Authority (IA) separately regulates the insurance industry.

*Law stated - 09 January 2023*

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

The HKMA regulates authorised banking institutions operating in Hong Kong, including banks, restricted licence banks (eg, merchant banks) and other deposit-taking companies. It supervises these authorised institutions (AIs) 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.

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, mergers and privatisations of listed companies; and
- the regulation of investment products (including, from April 2019, investment products offered by intermediaries via online platforms).

Als must register regulated securities activities undertaken in Hong Kong with the SFC, but the HKMA remains responsible for the day-to-day oversight of any such activities.

The Secretary for Financial Services also plays a coordinating role, and helps to set policy for the securities and futures markets generally.

*Law stated - 09 January 2023*

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

The HKMA exercises comprehensive supervisory oversight over the activities of Als, not 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 individuals), and include expectations and requirements as to the suitability of products offered or sold to third-party customers.

The SFC also regulates certain financial products, including securities and futures. The SFC directly authorises and regulates investment products, including:

- 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 - 09 January 2023*

## 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?

Financial services firms carrying on a regulated activity in Hong Kong, or marketing to the Hong Kong public, must be licensed by the SFC. A licence must be obtained (or a relevant exemption identified) for each type of regulated activity.

Licensing for actively marketing to the Hong Kong public is required whether the firm is marketing its services from Hong Kong or overseas. 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 representatives must also be licensed by the SFC before performing a regulated activity on behalf of their licensed corporation (LC). In addition, any executive directors (ie, senior managers) supervising an LC's regulated activities must also be licensed as 'responsible officers' (RO).

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

Licence applications are made to the SFC. Different requirements apply to each type of regulated activity, but at a minimum, the application process ordinarily requires the submission of extensive materials, including detailed business plans; biographies of senior personnel; and other corporate and individual records. All licensed persons – firms or individuals – must demonstrate 'fit and properness', involving an evaluation by the SFC of the applicant's financial status, qualifications, competence, honesty, fairness, reputation and character. Licensed firms must also comply with additional requirements, including on financial resources (eg, rules relating to minimum paid-up share capital and liquid capital) and insurance. The application process for temporary licences is less complex, especially for individuals.

Banking organisations are subject to authorisation by the HKMA when banking activities are undertaken in Hong Kong and/or marketed to customers in Hong Kong. Locally incorporated banking organisations are subject to different requirements than those applied to Hong Kong branches of overseas banks.

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 2022, there are a total of eight licensed virtual banks. Virtual banks are subject to the same supervisory principles and key requirements as conventional banks, subject to adaptation to suit their business model.

*Law stated - 09 January 2023*

## 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'.

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

*Law stated - 09 January 2023*

### 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 BO.

The BO sets out, among other things, the requirements for the 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 AIs; and liquidity and capital requirements. It also authorises the promulgation by the HKMA of

subsidiary legislation.

In addition to the BO and related legislation, institutions authorised by the HKMA must also comply with the minimum standards set out in the HKMA's Supervisory Policy Manual . The Supervisory Policy Manual codifies the HKMA's supervisory policies and 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, among other things, 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, of which there are a very significant number, together with a variety of codes of conduct, guidelines and circulars with varying degrees of legal effectiveness.

The Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615) (AMLO) sets out AML requirements applicable to financial institutions in Hong Kong, including KYC, customer due diligence and record-keeping, with the individual regulators issuing guidance and responsible for supervision and enforcement.

*Law stated - 09 January 2023*

### 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 AIs 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 specified, albeit comprehensively defined, securities and futures activities as set out under the SFO. The SFC 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 - 09 January 2023*

### 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. The SEHK is also the frontline regulator in respect of listing and listing applications.

*Law stated - 09 January 2023*

## 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?

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 which they regulate, and to compel the production of relevant documents by such firms. 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.

Both regulators are also given the authority to conduct enforcement investigations, which can lead to disciplinary, civil or criminal enforcement actions, albeit the HKMA's power to impose fines is limited to AML violations.

*Law stated - 09 January 2023*

### 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?

The HKMA and the SFC are authorised to take disciplinary or civil enforcement action for regulatory breaches. A wide range of sanctions is available in the disciplinary context, including licence revocation or suspension, fines (in the case of the SFC in particular) and reprimands. In many cases, the HKMA and the SFC also require the entities or persons responsible for regulatory violations to strengthen 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 receivership. In addition, the courts and relevant tribunals can require disgorgement, impose financial penalties, and enforce activity restrictions and prohibitions on future conduct.

In June 2022, the SFC announced a two-month consultation on proposed enforcement-related amendments to the SFO. The proposed amendments include expanding the basis on which the SFC may apply for remedial and other orders under section 213 of the SFO, narrowing the professional investor (PI) exemption in relation to investment advertisements and expanding the scope of the insider dealing provisions of the SFO to cover certain situations involving overseas securities or conduct. The consultation conclusions are yet to be released.

The HKMA and the SFC can also seek criminal prosecution for 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 cases 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 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, stating that an individual is unsuitable to be a director or senior management member of the named listed issuer. 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.

These revisions to the SEHK's disciplinary powers and sanctions were incorporated into the SEHK's revised Statement on Principles and Factors in Determining Sanctions and Directions Imposed by the Disciplinary Committee and the Listing Review Committee (Revised Sanctions Statement) in October 2022. The Revised Sanctions Statement provides further clarity on the SEHK's expectations in respect of a listed issuer's internal controls, and guidance on the circumstances in which an individual, such as a director or a staff member of a listed issuer, may reasonably rely on others in the discharge of their duties. The SEHK's Guidance Note on Cooperation, also issued in October 2022, provides examples of what may constitute good cooperation between the SEHK and the relevant stakeholders and the possible benefits of such cooperation. The Note also describes behaviour which may be construed as uncooperative, such as late production of submissions or evidence, and the possible consequences.

Following the execution of 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 2021, resulting in the arrest of listed company directors and senior management members for suspected corruption and market manipulation. Such joint enforcement efforts continued in 2022, including an operation targeting a syndicate operating suspected ramp-and-dump schemes. The joint operation involved a search by the SFC in relation to suspected market misconduct under the SFO, and eight arrests by the ICAC for suspected corruption offences under the Prevention of Bribery Ordinance (Cap 201).

*Law stated - 09 January 2023*

## **Tribunals**

### **What tribunals adjudicate financial services criminal and civil infractions?**

SFC disciplinary decisions are subject to appeal to the Securities and Futures Appeals Tribunal (SFAT), 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. The SFAT's final orders can be registered in or appealed to the Hong Kong courts.

Civil breaches of the SFO's market misconduct provisions are heard by public inquiry by the Market Misconduct Tribunal (MMT), a three-member panel (one judge and two lay members) with the SFC acts as the presenting officer. The MMT can issue injunctions, order disgorgement or impose prohibitions 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 - 09 January 2023*

## **Penalties**

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

The most common disciplinary sanctions are fines, public reprimands or licence suspensions, or some combination of the three. Serious violations can result in revocation of licences and bars from the industry. Penalties can range from

incidental amounts to well over HK\$400 million. Settlement of disciplinary actions is relatively common, but the regulators invariably will require a 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 - 09 January 2023*

## COMPLIANCE PROGRAMMES

### Programme requirements

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

The 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 a full range of principles-based requirements including in respect of internal controls; IT infrastructure and trading systems; the disclosure of firm financial information; the handling of client assets; and compliance obligations. New requirements on bookbuilding and placing activities in equity and debt capital market transactions were incorporated into the SFC Code of Conduct in August 2022 (ie, at paragraphs 17.1A and 21). 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 (SPM) sets out detailed guidance as to the compliance programmes expected of AIs, the principal focus being risk management. The SPM also includes a Code of Conduct for AIs and their employees. In December 2022, the HKMA published its revised Code of Conduct in an updated version of its SPM. The revisions to the SPM are intended to (1) strengthen the conflicts of interest policy requirements; (2) incorporate the relevant provisions of the Prevention of Bribery Ordinance (Cap 201) and raise staff awareness on corruption prevention; (3) update the existing guidelines to enhance the internal control systems for enforcing the Code of Conduct; and (4) enhance the guidance in relation to the adoption of group policies for foreign bank branches. Banks are expected to adopt any necessary changes by July 2023.

*Law stated - 09 January 2023*

## Gatekeepers

How important are gatekeepers in the regulatory structure?

Gatekeepers perform crucial functions within Hong Kong financial services firms. Under the Securities and Futures Ordinance (SFO), licensed corporations (LCs) in Hong Kong must appoint not less than two responsible officers (ROs) to directly supervise the conduct of each regulated activity, with at least one RO available at all times for supervision. ROs are expected to actively supervise the functions that they oversee and bear primary responsibility for compliance, including potentially being subject to disciplinary penalties for compliance failures. This expectation is codified in the SFC Code of Conduct applicable to all licensed entities.

In March 2022, the SFC addressed its concerns in respect of LCs' ability to cope with stress events in a Circular on Measures to deal with disruptions caused by financial distress and insufficient responsible officers. The Circular sets out the SFC's regulatory approach and expected standards to mitigate the risks and impact of an abrupt discontinuation of business and operations.

LCs are also subject to the SFC's manager-in-charge (MIC) regime, which defines and enhances the general risk management accountability of senior management of LCs. The SFC has identified eight core functions and requires a designated MIC for each, including compliance, AML/CFT, finance and accounting, risk management, and operational control and review. The MICs are subject to the SFC's disciplinary powers even if they are not themselves licensed persons (ie, traditional compliance, back-office and middle-office functions). In November 2021, the SFC announced its first disciplinary action against an individual MIC since the implementation of the MIC regime in 2017, where the LC's internal control failures were attributed to the individual MIC's failure to discharge his duties as an RO and a member of the LC's senior management. In October 2022, the SFC issued its first disciplinary action against an LC's former Head of Compliance and MIC of Compliance for overseas compliance failures relating to the European Union's short-selling reporting requirements.

There is a parallel regime for AIs, for 'Section 72B Managers' under the Banking Ordinance (BO), regulated by the HKMA. Generally, 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 SPM does, however, set out detailed and extensive guidance as to the role of the internal audit function. The board of directors is principally responsible for ensuring that these functions are adequately resourced.

The regulation of IPOs in Hong Kong requires sponsors to act as gatekeepers, positively affirming the suitability for listing of listing applicants.

*Law stated - 09 January 2023*

## **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), which displaces the common law standard of care. In determining whether a director's duties have been breached, Hong Kong courts will apply a mixed subjective and objective test, comparing the director's conduct 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 consider the need to instil a strong compliance culture, including a sufficiently robust 'tone from the top'. This is especially important in light of a heightened regulatory focus on individual and senior management accountability (eg, the MIC regime).

In December 2021, the 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 describes 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 - 09 January 2023*

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

Directors may be held individually accountable for regulatory breaches by financial services firms. For instance, the SFC may seek injunctive relief against persons who contravene 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 LCs who are also ROs or MICs are also subject to the SFC's disciplinary powers if found liable for the misconduct of financial services firms.

Recent enforcement actions 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 January 2022, the MMT announced its findings against Tianhe Chemicals Group Limited and its executive director, who were found to be guilty of market misconduct for issuing a false or misleading IPO prospectus in 2014 that overstated the company's revenue. The MMT banned the executive director from being a director or a member of the management of a listed company for four years.

*Law stated - 09 January 2023*

### Private rights of action

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

Private rights of action for regulatory violations are available in only 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 private rights of action are required to pay damages if it is fair, just and reasonable in the circumstances. Hong Kong courts may also impose injunctive relief in addition to or in lieu of orders for damages. Potential defendants are not limited to direct perpetrators of market misconduct offences, but may include persons who knowingly assist or connive with others who perpetrate 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' are widely defined in the SFO as directors, managers, secretaries and any other person involved in the management of a corporation.

*Law stated - 09 January 2023*

### **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 contractual, as applied within the context of the common law duties of banks.

In addition, financial services firms must meet minimum, principles-based regulatory standards governing the treatment of customers, which are principally set out in the SFC Code of Conduct. The standards require 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 particularises minimum requirements in respect of, among other things, the content of client agreements and the principles of prompt and best execution.

Similarly, AIs are expected to comply with the recommended practices prescribed in the Code of Banking Practice. The Code of Banking Practice sets out detailed expectations for the treatment of banking customers, 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, among which is the equitable and fair treatment of customers, with special attention given to the needs of vulnerable groups. Amendments to the Code of Banking Practice announced in 2021 and again in 2022 have focused on reflecting local and international expectations in relation to digital banking services (including social media promotions).

*Law stated - 09 January 2023*

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

In respect of securities and futures activity, the standard of care owed to customers varies based on the sophistication of the customer.

Under the SFO and related SFC guidance, certain customers may be classified as Professional Investors (PI). For PIs, the protection is relaxed, including obligations to obtain information about a customer's financial condition, experience and objectives; the minimum contents of client agreements; requirements to assess suitability of investment products; and the type of transaction-related information to be disclosed.

The HKMA also recognises certain categories of customers (eg, private banking customers) for which suitability and other requirements are less onerous. 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 customers (eg, the elderly).

*Law stated - 09 January 2023*

## Rule-making

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

Subsidiary legislation in Hong Kong ordinarily undergoes consultation prior to adoption and requires legislative negative vetting as a minimum. Consultation is cross-regulator, where appropriate, and public, including 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 in statute or subsidiary legislation. Major guidance is frequently subject to public consultation, but not minor or merely technical guidance or rule changes.

*Law stated - 09 January 2023*

## 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.

One potential exception to this territorial approach is the catch-all fraud provision of the Securities and Futures Ordinance (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. Although significant elements of the fraudulent scheme in that case were devised in Hong Kong, the SFC's action demonstrates that it will



use its ostensibly territorial jurisdiction to reach conduct that principally occurs offshore, especially where it impacts Hong Kong's markets and market participants.

The SFC is currently consulting on amending insider dealing legislation to cover trading on overseas markets.

Overseas activities of banking organisations authorised in Hong Kong are also subject to regulation, including the Hong Kong Monetary Authority (HKMA)'s powers of inspection. Als require the HKMA's approval to open branches or acquire banks overseas, and must regularly disclose the assets and liabilities of their overseas entities to the HKMA. The HKMA liaises 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 must be satisfied that overseas-incorporated banks are adequately supervised by their home regulators before authorising them to conduct banking activities in Hong Kong. Overseas banks without such authorisation cannot engage in any banking business in Hong Kong, although they may open local representative offices so long as they confine customer business to representational and liaison activities.

The SFC and the HKMA also cooperate extensively with international regulators.

The SFC and the China Securities Regulatory Commission (CSRC) hold regular meetings to discuss cross-boundary enforcement cooperation. In a November 2022 meeting , the SFC and the CSRC reached consensus on various aspects, including recognition of the efficient operation of cross-boundary enforcement cooperation and exchange mechanisms between the two enforcement units, the need for mutual assistance on investigations, and the need to identify areas for further cooperation and enhancements.

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.

*Law stated - 09 January 2023*

## 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.

Historically, the SFC has played a leading role in the activities of IOSCO, and IOSCO recommendations are generally adopted in Hong Kong.

The HKMA has committed to implementing the Basel III reforms proposed by the Basel Committee on Banking Supervision. In July 2019, the HKMA implemented the Banking (Exposure Limits) Rules , which aim to implement the Basel Committee's large exposures standards. Regarding other Basel III reforms yet to be implemented, the HKMA



announced in November 2022 that it expects the relevant frameworks and standards to be revised by a date no earlier than 1 January 2024.

In the AML/CFT sector, the Hong Kong government works 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 July 2022, the government published the updated Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report as required by the FATF standards. Consistent with the 2018 assessment, this report found that Hong Kong is exposed to a medium to high level of money laundering risk, comprising a medium-high level of threat and medium level of vulnerability. In addition, various amendments to the Hong Kong AML/CFT statutory framework passed in December 2022 were intended to ensure alignment with the latest FATF standards (eg, around the definition of 'politically exposed person' and the use of digital identification for purposes of customer due diligence).

*Law stated - 09 January 2023*

## 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 crypto-assets

As in recent years, the authorisation and regulation of virtual assets (VAs) (eg, digital currencies, crypto-assets, etc) and the platforms on which they are traded (ie, virtual asset service providers (VASPs)) have continued to be a point of focus.

Following the passage of the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 on 7 December 2022, a VASP licensing regime will take effect from 1 June 2023. The Bill is the first VA-specific legislation in Hong Kong. Under the legislation, any person who engages in VA exchange business must obtain a licence from the Securities and Futures Commission (SFC), satisfy the fit and proper test, and comply with applicable anti-money laundering and counter-financing of terrorism (AML/CFT) and other regulatory requirements on investor protection. Additionally, licensed VA exchanges and their wholly owned subsidiaries will be required to regularly submit audited accounts and financial information to the SFC. The SFC plans to carry out a further consultation on the detailed regulatory requirements.

The new mandatory licensing regime marks a shift from the previous, more permissive 'opt-in' system announced by the SFC in 2019, under which VASPs operating in Hong Kong could voluntarily opt in to be regulated by applying for a licence.

As at 10 November 2022, the SFC has only granted two VASP licences.

This shift has also been reflected by the Policy Statement on Development of Virtual Assets in Hong Kong issued on 31 October 2022, where the government expressed that it hoped to facilitate VA innovation in a sustainable manner while managing risks to financial stability, consumer protection, and AML/CFT objectives.

On 13 December 2022, the SFC issued a statement reminding investors that VA 'deposits', 'savings', 'earnings' or 'staking' services (VA Arrangements) offered by VA platforms to investors in Hong Kong could amount to a collective investment scheme under the SFO and may require authorisation by the SFC unless an exemption under the SFO applies.

The Hong Kong Monetary Authority (HKMA) has also been active in evaluating how to approach VAs and crypto-assets. 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 crypto-assets 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 crypto-assets 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 crypto-assets 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 were 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 continued to be areas of regulatory focus in 2022, including:

- In August 2022, the SFC published its Agenda for Green and Sustainable Finance to set out further steps to support Hong Kong's role as a regional green finance centre. The SFC's work will focus on: (1) enhancing corporate disclosures; (2) monitoring the implementation of and enhancing existing measures relating to environmental, social and governance (ESG) funds and expectations for fund managers; and (3) identifying an appropriate regulatory framework for any proposed carbon markets.
- In October 2022, HKEx launched 'Core Climate', a new international carbon marketplace for trading carbon credits and instruments, which is intended to provide an integrated carbon marketplace that includes trading, custody and settlement functions for corporations, investors and project owners.
- In November 2022, HKEx published the findings of its review of listed issuers' compliance with its ESG Reporting Guide, focusing on the issuers' ESG practices in board governance of ESG issues, climate change, social issues and reporting practices.
- In December 2022, the HKMA published a Dear CEO letter (with an attached Annex) covering greenwashing risks and setting out due diligence processes for green and sustainable products offered by AIs. This guidance arose from the HKMA's recent thematic examinations focused on the development and ongoing management of green and sustainable products, including a review of AIs' systems to reduce potential exposure to greenwashing risks. In December 2022, the HKMA's updated SPM included climate risk as an emerging risk type covered by the HKMA's risk-based supervisory approach.

## Markets

In December 2022, the SFC announced that following various consultations and monitoring of market readiness, it will launch the Hong Kong Investor Identification Regime (HKIIR) on 20 March 2023. Under the HKIIR, brokerages and financial institutions ('relevant regulated intermediaries') will, for the first time, be required to submit clients' names to the SEHK when placing orders. Currently, the SEHK's systems only show brokers' names with client identities provided upon request of the SFC.

## Consumer protection





In April 2022, the HKMA issued guidance on sound practices for customer data protection observed from a recent round of thematic examinations. The guidance grouped the recommendations into four categories: (1) data

governance; (2) customer data inventory management; (3) controls over transmission and storage of customer data; and (4) physical and logical security controls of customer data.

In the midst of the emergence of 'Buy Now, Pay Later' products across the globe, the HKMA issued guidance in September 2022 setting out its expectations for consumer protection for these new consumer credit products.

*Law stated - 09 January 2023*

## Jurisdictions

	<b>Australia</b>	Herbert Smith Freehills LLP
	<b>Egypt</b>	Soliman, Hashish & Partners
	<b>Finland</b>	Waselius & Wist
	<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>United Kingdom</b>	Davis Polk & Wardwell LLP
	<b>USA</b>	Davis Polk & Wardwell LLP