



Hong Kong

April 2020

## SFC PUBLISHES GUIDANCE TO LICENSED INTERMEDIARIES AMID COVID-19

The Securities and Futures Commission (the **SFC**) issued a press release<sup>1</sup> on 21 April 2020 outlining the measures it has implemented in response to the effect of the COVID-19 outbreak on Hong Kong's capital markets. Its main areas of focus have been ensuring that Hong Kong's financial markets continue to function efficiently, assuring investor protection, and preserving market integrity, against a background of extreme market volatility and the challenges posed by special work arrangements adopted due to the pandemic.

The SFC has thus issued guidance to SFC-licensed brokers on how to comply with regulatory requirements, such as brokers' order recording obligations of client orders taken outside the office, and focussed on potential vulnerabilities arising from the exceptional market conditions that have arisen in the wake of COVID-19. For example, the SFC has issued guidance to fund managers on their obligations to treat investors fairly, particularly if they propose to activate liquidity risk management measures (e.g. swing pricing or suspensions), and to market makers on their risk management obligations. The guidance issued by the SFC is summarised in the press release.

All information issued by the SFC in relation to COVID-19 is available on a dedicated SFC website at <https://www.sfc.hk/web/EN/information-for-firms-on-covid-19.html>.<sup>2</sup>

1 SFC. SFC regulatory response to COVID-19. 21 April 2020. Available at: <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR35>

2 <https://www.sfc.hk/web/EN/information-for-firms-on-covid-19.html>

The following is a summary of the SFC's guidance for SFC-licensed intermediaries, other than that directed at fund managers, which is the subject of a separate newsletter.

### 1. Circular to Intermediaries - Reminder of important obligations to ensure suitability and timely dissemination of information to clients<sup>3</sup>

This circular issued on 27 March 2020 focusses on the obligations of licensed and registered persons under the SFC's Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the **SFC Code of Conduct**) in distributing investment products to clients, particularly the:

- i) suitability obligations in making a solicitation or recommendation under paragraph 5.2 of the SFC Code of Conduct as supplemented by the FAQs on Triggering of Suitability Obligations<sup>4</sup> and FAQs on Compliance with Suitability Obligations<sup>5</sup> of December 2016; and

3 SFC. Circular to Intermediaries – Reminder of important obligations to ensure suitability and timely dissemination of information to clients. 27 March 2020. Available at: <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/suitability/doc?refNo=20EC25>

4 SFC. Frequently Asked Questions on Triggering of Suitability Obligations. December 2016. Available at: <https://www.sfc.hk/web/EN/faqs/intermediaries/supervision/triggering-of-suitability-obligations/triggering-of-suitability-obligations.html>

5 SFC. FAQs on Compliance with Suitability Obligations by Licensed or Registered Persons of December 2016. Available at: <https://www.sfc.hk/web/EN/faqs/intermediaries/supervision/suitability-obligations-of-investment-advisers/compliance-with-suitability-obligations.html>

- ii) obligation to disseminate information on a timely basis when holding an investment product directly or indirectly on behalf of clients.

It reminds licensed and registered persons of their suitability obligations under the SFC Code of Conduct which require them to:

- a) ensure that due diligence is conducted on investment products on the current approved product lists on a continuous basis at appropriate intervals. Due diligence should take into consideration the nature, features and risks of investment products, including any deterioration in credit quality or liquidity, market and industry risks related to the COVID-19 outbreak and other factors which may have an impact on the risk return profiles and growth prospects of the investments;
- b) give due consideration to all relevant circumstances specific to a client when assessing the suitability of an investment product for the client, including the client's current financial situation, investment objectives, risk tolerance, investment horizon and liquidity needs, as well as the risk profile and concentration risk of the existing investment portfolio;
- c) explain to clients the risks and features of the investment product, including its credit quality, liquidity, termination conditions and transaction costs; and
- d) present balanced views at all times when recommending an investment product to a client and not focus solely on advantageous terms such as high coupon rates or yields, and to explain the disadvantages and downside risks, such as credit deterioration and illiquidity.

Where licensed or registered persons hold investment products directly or indirectly on behalf of their clients, they are reminded of their duty to disseminate notices and other communications prepared or issued by the investment products' issuers, product arrangers or management companies to their clients upon receipt in a timely manner. Such notices or communications may include material information or updates crucial for investment decisions, e.g., untoward circumstances relating to a fund which may include the use of liquidity risk management tools by a fund manager.

## 2. Circular to intermediaries - Extended deadlines for implementation of regulatory expectations and reminder of order recording requirements under COVID-19 pandemic<sup>6</sup>

This circular: (i) informs the industry of the SFC's decision to extend by six months the deadlines for the implementation of three regulatory expectations due for implementation in 2020; and (ii) reminds intermediaries of the alternative order recording options that are available under the existing regulatory framework.

- i) Extension of deadlines for implementing regulatory expectations

The deadlines for three regulatory expectations, namely: (i) use of external electronic data storage, (ii) new measures to protect client assets; and (iii) data standards for order life cycles have been extended by six months.

- ii) Adherence to client order recording requirements

Due to the remote working arrangements adopted during the COVID-19 pandemic, certain intermediaries may find it difficult to fully comply with the order recording requirements set out in paragraph 3.9 of the SFC Code of Conduct.

The SFC reminds intermediaries of the alternative order receiving and recording options which can be used to comply with the regulatory requirements. Intermediaries should adopt them as appropriate to meet the needs of their current circumstances.

Intermediaries should keep in mind that appropriate control measures are required to ensure the proper implementation of alternative means of complying with order recording requirements. The circular also emphasises that in order to protect the interests of both the intermediaries and clients, complete and accurate records must be kept as a crucial part of the audit trail so that there is reliable evidence to assess disputes with clients over particulars of a trade order.

For further details, please refer to Charltons' newsletter on the

<sup>6</sup> SFC. Circular to intermediaries: Extended deadlines for implementation of regulatory expectations and reminder of order recording requirements under COVID-19 pandemic. 31 March 2020. Available at: <https://www.sfc.hk/edistributionWeb/gateway/EN/circular/intermediaries/supervision/doc?refNo=20EC26>

circular<sup>7</sup> available at: <https://www.charltonslaw.com/sfc-extends-deadlines-for-implementing-regulatory-expectations-and-reminds-intermediaries-of-order-recording-requirements-amidst-covid-19-pandemic/>.

### 3. Compliance with contract notes, statements of account and receipts rules<sup>8</sup>

In relation to compliance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules (**Contract Notes Rules**), in light of the suspension of various overseas postal services due to the COVID-19 crisis, the position of the SFC is that the same principle and approach as stated in the SFC's email dated 31 January 2020<sup>9</sup> on "Compliance with the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules" will be adopted.

In case of delay in licensed corporations' provision of contract notes, statements of account and receipts by post due to the suspension of local or overseas postal services, licensed corporations are not expected to give written notice to the SFC under section 18 of the Contract Notes Rules.

### 4. Submission of audited accounts and other documents under section 156(1) of the Securities and Futures Ordinance (SFO)<sup>10</sup>

Section 156(1) of the SFO requires licensed corporations and their associated entities (excluding authorized financial institutions) to submit their audited accounts and other required documents to the SFC within four months after the end of each financial year. Given the current situation caused by the pandemic, certain licensed corporations and associated entities may not be able to submit their audited accounts within the required timeframe.

If a licensed corporation or associated entity anticipates delay in preparing its audited accounts or other documents, it could

consider applying for an extension of the submission period by using Form B (licensed corporations) or Form E (associated entities) published on the SFC's website or via the SFC Online Portal, as soon as practicable. The impact of the coronavirus situation on the licensed corporation or associated entity as well as its auditors would be taken into account by the SFC in processing such application.

### 5. Licensing related matters in light of the COVID-19 pandemic

The SFC recognises that intermediaries or licensing applicants may have difficulties in fulfilling their obligations in licensing matters because of the restrictions on travel, public gatherings and lockdowns. To provide regulatory flexibility in assisting intermediaries in dealing with the inconvenience brought by the pandemic, the SFC has issued FAQs on Licensing Related Matters in light of the COVID-19 Pandemic<sup>11</sup> providing examples of some of the enquiries intermediaries and licensing applicants may have. These cover a range of issues, including:

- i) A three-month extension for any deadline for passing regulatory examinations falling due before 30 September 2020. It is not necessary to apply for this extension;
- ii) A three-month extension for any undertaking to complete additional Continuous Professional Training (**CPT**) hours on or before 30 September 2020;
- iii) Allowing licensed individuals who cannot complete the annual CPT requirement before 31 December 2020 to carry forward any unfulfilled CPT hours to 2021. The circular also notes that online courses, which are regarded as self-study, can be completed and will fulfil the CPT requirement;
- iv) The situations in which a licensed corporation is required to immediately notify the SFC under section 4 and paragraph 9 of Schedule 3 to the Securities and Futures (Licensing and Registration) (Information) Rules which require notification of significant changes to a licensed corporation's business plan, including internal controls, organizational structure, contingency plans and

7 Charltons. SFC Extends Deadlines for Implementing Regulatory Expectations and Reminds Intermediaries of Order Recording Requirements amidst COVID-19 Pandemic. April 2020. Available at: <https://www.charltonslaw.com/sfc-extends-deadlines-for-implementing-regulatory-expectations-and-reminds-intermediaries-of-order-recording-requirements-amidst-covid-19-pandemic/>

8 Available at: <https://www.sfc.hk/web/EN/files/ER/Email%20on%20COVID.pdf>

9 Available at: [https://www.sfc.hk/web/EN/files/ER/CNR\\_email\\_31012020.pdf](https://www.sfc.hk/web/EN/files/ER/CNR_email_31012020.pdf)

10 Available at: [https://www.sfc.hk/web/EN/files/LIC/pdf/Audited%20Accounts%20-%2020200207%20\(Eng\)%20\(002\).pdf](https://www.sfc.hk/web/EN/files/LIC/pdf/Audited%20Accounts%20-%2020200207%20(Eng)%20(002).pdf)

11 Available at: <https://www.sfc.hk/web/EN/files/ER/Email%20on%20COVID.pdf>

related matters. The SFC give the following non-exhaustive examples of matters it expects to be notified of:

- a) Confirmation of staff infection which may have an impact on the licensed corporation's operations;
- b) Closing office premises as a result of staff infection or government lockdown, including overseas office premises, if the closure has implications for the licensed corporation's operations or the carrying on of its regulated activities (e.g., temporary closing of overseas office premises which handles back and middle office functions);
- c) Changes to its organisational resources (e.g., split team arrangements, staff relocation to overseas offices); and
- d) The triggering of the licensed corporation's business continuity plan;
- v) The need for an overseas individual to obtain a temporary representative licence in order to provide regulated activities provided by teleconference or video conference with Hong Kong clients from overseas;
- vi) The situation where a licensed corporation has to temporarily shut its trading desk due to the COVID-19 pandemic. The question posed is whether in these circumstances, the traders of an overseas affiliate who are based outside Hong Kong and not licensed by the SFC can cover the licensed corporation's trading activities so that its clients can continue to be served. The SFC's response notes the requirement for licensed corporations to maintain a back-up office and have remote access to trading facilities so that they can continue to provide trading services if the main dealing desk is shut down. It notes however that if the back-up facilities fail and orders have to be routed to an offshore affiliate for execution, the licensed corporation should immediately notify the SFC and seek approvals from the SFC and overseas authorities for trading offshore where necessary. In these exceptional circumstances, the SFC would be flexible in assisting the licensed corporation to continue to serve its clients;
- vii) Regarding the requirement for licensed corporations to obtain prior SFC approval for using any premises to keep records or documents relating to its regulated activities under section 130 SFO, the SFC recognises that licensed corporations may arrange for their staff to work from home, their overseas offices or the overseas offices of their affiliates. The SFC requires licensed corporations to ensure that staff are able to remotely access the licensed corporation's trading or other systems and that staff activities will be captured in the records and documents generated by these systems. If certain records and documents need to be kept in unapproved premises temporarily, they should be sent back to the licensed corporation's approved premises as soon as is practicable;
- viii) Regarding the requirement for an offshore licence applicant to submit signed pages of a temporary licence application where the applicant's jurisdiction has suspended postal services or enforced "stay-at-home" restrictions, applicants can send electronically a copy of the signed pages and state reasons why printed versions cannot be sent. The signed pages must be sent when the situation returns to normal; and
- ix) Regarding licensed corporations' and associated entities' obligation to submit audited accounts within four months of their financial year-end, an extension of the submission period can be applied for by submitting Form B (licensed corporations) or Form E (for associated entities).

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