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Summary of the Consultation Conclusions of the SFC proposal to implement a regulatory regime for depositaries of SFC-authorized collective investment schemes



Introduction

After receiving general support for a proposed regulatory framework in the [public consultation for a proposed regulatory framework for depositaries of SFC-authorized collective investment scheme](#) in September 2019 ("**First Consultation**"), the Hong Kong Securities and Futures Commission ("**SFC**") published a new consultation in February 2022 regarding the [proposed amendments to subsidiary legislation SFC codes and guidelines to implement the new regulatory framework](#) ("**Second Consultation**"). The consultation period for the second consultation closed in April 2022 and the SFC published the [consultation conclusion](#) in March 2023 ("**Consultation Conclusion**").

This client briefing summarises the comments made by the SFC in response to the public consultation on amendments proposed for subsidiary legislation as set out in the Consultation Conclusion.

Definition of RA13

In summary, following the positive feedback that the SFC received in the First Consultation, the SFC has decided to introduce a new type 13 regulated activity ("**RA13**"). RA13 refers to the activity of providing depositary services for a Relevant CIS by acting as its top-level depositary, and includes the custody and safekeeping of Relevant CIS property and oversight of the Relevant CIS to ensure that it is operated in accordance with the provision of its constitutive documents. This is normally the trustee, if the Relevant CIS

is constituted in the form of a trust, or the custodian, if the Relevant CIS is constituted in any other form. RA13 does not include the provision of service by a delegate or sub-delegate of the RA13 licensed corporation.

Relevant CIS ("**Relevant CIS**") will include the collective investment schemes authorised by the SFC under section 104 of the SFO, but will exclude any registered scheme or its constituent fund under the Mandatory Provident Fund Scheme Ordinance (Cap 485) ("**MPFSO**") or any approved pooled investment fund under the Mandatory Provident Fund Schemes (General) Regulation (Cap 485A) which is offered only to professional investors, employers under the MPFSO, other registered schemes under the MPFSO, or occupational retirement schemes or pooling agreements under the Occupational Retirement Schemes Ordinance (Cap 426).

In particular, it was noted in the Consultation Conclusion that the public thought that the scope of the depositary oversight function, which was only proposed in the Second Consultation, is wider than the existing requirements under the "**Product Codes**" (collectively refers to the Code on Unit Trusts and Mutual Funds (the "**UT Code**"), the Code on Pooled Retirement Funds (the "**PRF Code**"), the Code on Real Estate Investment Trusts (the "**REIT Code**") and the Code on Open-Ended Fund Companies). This view was rejected by the SFC. No further change will therefore be made to the definition of RA13.

On Subsidiary Legislation

To accommodate the new licensing regime, several subsidiary legislation will need to be amended to include RA13. Following the feedback that the SFC received from the public in the Second Consultation on the proposed amendments to be made to various subsidiary legislation, including the Securities and Futures (Client Securities) Rules, the Securities and Futures (Client Money), the Securities and Futures (Keeping of Records) Rules, the Securities and Futures (Financial Resources) Rules, the Securities and Futures (Insurance) Rules, the Securities and Futures (Accounts and Audit) Rules, the Securities and Futures (Contract Notes Statements of Account and Receipts) Rules and the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (collectively, the "**Subsidiary Legislation**"), the SFC appended to the Consultation Conclusion an appendix A that contains a summary of the public comments on the proposed Subsidiary Legislation that the SFC received in the Second Consultation and the SFC's responses to them, and an appendix B that contains the final forms of the Subsidiary Legislation that will apply to licensed corporations, including the ones licensed for the RA13 activity ("**RA13 Depositary(ies)**").

One particular concern expressed by the public in the Consultation Conclusion is the scope of "client assets and associated entities" of a RA13 Depositary, as they considered that the existing definition in the Subsidiary Legislation would not be suitable for their circumstances. The SFC explained:

- (1) in respect of "client assets", this would only applies to scheme securities, scheme money, scheme assets (which can be seen as a subset of client securities, client money and client assets, but specific for the RA13) and Relevant CIS property held by the RA13 Depositary. Further changes will be made to the Subsidiary Legislation to reflect this; and
- (2) in respect of "associated entities", this only applies to an entity that is in a controlling entity relationship with a RA13 Depositary and holds scheme assets, so that not every global custodian in the same banking group will be an "associated entity" and subject to the Subsidiary Legislation.

Other regulations that apply to other licensed corporations will apply to the RA13 Depositary, such as the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**") (subject to the change explained below), the Management, Supervision, and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (Internal Control Guidelines) and the Product Codes.

On Schedule 11 of the Code of Conduct

In the First Consultation, a proposed form of a new schedule 11 to the Code of Conduct was introduced. This was revised in the Second Consultation after the public's feedback. Following that, the SFC is now proposing a final form of the new schedule, which is set out under appendix C of the Consultation Conclusion ("**Schedule 11**"). Schedule 11 mainly deals with the RA13 Depositary's obligations to have oversight over the Relevant CIS and the relevant operator (this refers to anyone involved in the operation of the Relevant CIS, which may include the management company, board of directors, a transfer agent, administrator, registrar and product provider) ("**Relevant Operator**").

Schedule 11 will be separated into two parts, one applicable to RA13 Depositaries that provide services to a Relevant CIS authorised under the UT Code or the PRF Code, and the other for the REIT Code.

In particular, Schedule 11 will require the RA13 Depositaries, inter alia:

- (1) to have effective and timely communication with the management company, particularly to identify, report, rectify and remedy actual or potential material breaches of applicable legal and regulatory requirements;
- (2) if applicable, to have internal control policies and procedures over any delegate or third party of the Relevant CIS so that the RA13 Depositary can assess the competence, regulatory and financial status, capabilities and internal controls and systems of the delegates or the third parties, to monitor the delegates or the third parties to ensure compliance, to address any conflicts of interests, to establish appropriate contingency plan in relation to the delegates or the third parties;
- (3) to ensure that the RA13 Depositary's record-keeping policies comply with all applicable legal and regulatory requirements, as well as the requirements in the constitutive documents of the Relevant CIS;
- (4) to have oversight of the Relevant CIS, or the Relevant Operators. In particular, the RA13 Depositaries should have oversight over, amongst other things, the subscription and redemption process of the Relevant CIS, property valuation and NAV calculation methodology, pricing error, distributions, cash flow, investments, conflict of interests, fair treatment of different classes of units or investors and connected transactions;
- (5) to establish a clear and comprehensive escalation mechanism for any error or exception in the pricing;
- (6) to ensure the timely transfer of distribution proceeds upon the instruction of the Relevant Operator;
- (7) to control the opening and maintenance of any bank account for the Relevant CIS, and to identify inconsistent cash flows;
- (8) to carry out investment instruction of the management company with post-trade verification of any investment limits and restrictions, to provide copies of reconciled records of Relevant CIS property and transactions executed for and on behalf of the Relevant CIS;
- (9) to have adequate organisational arrangements to minimise the risk of loss of the Relevant CIS property, to properly record Relevant CIS property with frequent reconciliations, to segregate Relevant CIS property, to properly safekeep and register the Relevant CIS property; and
- (10) if any segregated or omnibus account is opened and maintained by the RA13 Depositary to hold subscription proceeds, redemption proceeds or distribution proceeds, then to hold the proceeds on trust for and on behalf of the Relevant CIS investor.

In respect of RA13 Depositaries of funds authorised under the REIT Code, they should observe the same rules under Schedule 11 but with certain modifications.

Other amendments

Other than the proposed amendments mentioned above, the SFC also proposed amendments to the Product Codes, the Fund Manager Code of Conduct, Guidelines on Competency and AML/CFT obligations in the Second Consultation. There was only minimal feedback from the public on these so the SFC will proceed according to the forms proposed in the Second Consultation.

Transitional arrangements

Regarding transitional arrangements, the SFC clarified that transitional arrangements apply to all trustees and custodians providing depositary services for Relevant CISs in Hong Kong, and that these firms must be licensed or registered for RA13 to continue these services. Individuals engaged by a depositary to provide depositary services during the transitional period will be exempted from passing the local regulatory framework paper, provided they complete a course of not less than 5 hours on the legal and regulatory framework for RA13. There is no requirement for work experience attached to this grandfathering arrangement, but individuals will be required to satisfy other competence requirements as detailed in the Guidelines on Competence.

Next steps

The proposed amendments to the SFO and the Subsidiary Legislation were gazetted by the government for negative vetting in the Legislative Council on the 24th March 2023, and a subcommittee was formed to consider the proposed amendments. The expectation of the SFC is that the RA13 regime will come into effect on 2 October 2024 when the transitional period comes to an end.

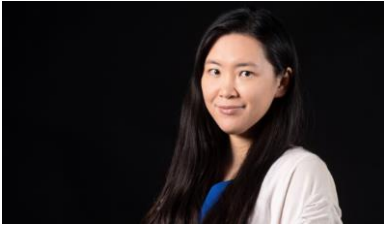
How we can help

Whilst it is anticipated that the operation of trustees/custodians of funds in Hong Kong will substantially remain the same, the new regime will impose new obligations on professional trustees/custodians. In particular, it is expected the RA13 Depositaries will play a bigger role in the operation of funds and perform check and balance functions.

Many of our clients are fund managers and trustees/custodians and we regularly provide fund formation and compliance and regulatory advice to our clients.

Please get in touch if you are interested in discussing any of the above.

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