



# Financial Services Risk and Regulation

Regulatory updates newsletter | May 2022



Tiang & Partners  
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# Introduction



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The position limit regime, which comprises statutory prescribed limits and reportable position reporting requirements, was enhanced after the Asian Financial Crisis in 1997-98 to strengthen the transparency and orderliness of the Hong Kong securities and futures markets and prevent and discourage the build-up of positions which may affect the orderly functioning and stability of the Hong Kong financial market. Over the years, the position limit regime has helped the SFC fulfil its regulatory objectives of maintaining and promoting an orderly securities and futures industry. On 26 April 2022, the SFC published a consultation paper on proposed changes to the position limit regime for listed futures and options contracts. The proposed changes aim to prevent and discourage the building up of futures and options contracts positions that could threaten market stability.

In this edition of the newsletter, we also discuss the HKMA circular on Mandatory Reference Checking (“MRC”) Scheme. In mid-2020, the HKMA consulted the banking industry on a proposed framework to facilitate AIs to bilaterally obtain reference information during their recruitment process for certain positions, such that misconduct information in an individual’s previous employments can be provided to AIs to inform their employment decisions. In May 2021, the HKMA issued the consultation conclusions that set out the underlying principles and key parameters for the MRC Scheme taking into account the responses received from the banking industry. On 5 May 2022, the Hong Kong Association of Banks and the DTC Association issued guidelines on the MRC Scheme, and the HKMA endorsed the MRC Scheme.

There are also other regulatory updates from the HKMA and SFC in this period, which are highlighted in this edition.

We hope you find our summary of these regulatory updates useful. We look forward to your feedback.

A handwritten signature in blue ink, appearing to read 'Adams Chan', written in a cursive style.

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# SFC Consultation on Proposed Changes to Position Limit Regime



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On 26 April, the SFC published a consultation paper on proposed changes to the position limit regime for listed futures and options contracts.

In light of recent market developments, the proposed changes aim to prevent and discourage the building up of futures and options contracts positions that could threaten market stability.

## Unit Trusts – prescribed position limits and reportable positions

- There is a misconception in the industry that the position limit regime will not apply to a unit trust as it does not qualify as a “person” as defined under the Interpretation and General Clauses Ordinance. To address this misconception, the SFC proposed to amend the Securities and Futures (Contracts Limits and Reportable Positions) Rules (the “Rules”) and the Guidance Note on Position Limits and Large Open Position Reporting Requirements (the “GN”). The amendments serve to clarify trustees’ obligations to report reportable positions on behalf of a unit trust fund.
- Further, it is proposed that if a trustee acts for multiple unit trusts, i) separate reporting on the reportable positions for each unit trust is required and ii) all positions in the unit trusts must comply with the prescribed limits. While the current Rules require a reporting notice to specify the “person’s” identity, the proposed change requires the specification of the unit trust’s name instead.

## Sub-funds of an umbrella fund

- The consultation addressed the two common types of legal structures for an umbrella fund, being unit

trusts and corporate funds. It is proposed that separate reporting for each sub-fund under the umbrella fund on the reportable positions is required and prescribed limits should apply to each sub-fund individually and separately as if each one were a stand-alone fund. Notices for reporting these reportable positions should include the name of the sub-fund and number of contracts held. These changes are proposed to be incorporated into the Rules.

## Clearing of clients’ positions by Clearing participants (“CPs”)

- When a person (“Person A”) has a discretion to buy or sell contracts on behalf of another (“Person B”) under section 7(3) of the Rules, Person A will need to aggregate all the futures and options contracts held or controlled for Person B together with his or her own for complying with the prescribed limits and reporting the reportable positions.
- Under the existing Rules, there is some uncertainty about the application of section 7(3). The SFC proposed to amend the Rules to make it clear that a CP would not be regarded as exercising a discretion under section 7(3) of the Rules if it closes out a client’s position when the client has defaulted on payments.

## Authorisation mechanism for CPs to hold excess positions

- When an authorised person holds or controls contracts exceeding the prescribed limit, it is common practice that either i) the authorised person itself (if it is also a CP) or ii) a CP of the recognised clearing house concerned would clear

the excess positions. Separate authorisation from the SFC is generally not required if the authorised person is also a CP as in i) above. However, if authorised exchange participants (“EPs”) are clearing excess positions through the services of a General Clearing Participant (“GCP”), the GCP must also be authorised to hold the excess positions and it would be a breach of section 4 of the Rules if no authorisation is obtained by the GCP. Hence, the SFC proposed to include in the GN an authorisation mechanism to cater for the scenario when CPs or GCPs are providing services to persons who are authorised by the SFC, such as the EPs.

In addition to the above changes, the SFC also proposed to amend the Rules to prescribe reportable positions for futures and options contracts traded during holidays to complement the introduction of the Derivatives Holiday Trading by the Hong Kong Exchanges and Clearing Limited. Schedule 1 of the Rules will also be expanded to include a list of proposed new contracts such that the position limit regime would be extended to those.

These changes on position limit regime proposed in the consultation will satisfy the need to fulfil the requirements under the SFC’s policies and objectives. The public is invited to submit their comments by 27 June 2022.

## Additional Reading

[SFC announcements on consultation](#)

[Consultation paper](#)

# HKMA Circular on Mandatory Reference Checking Scheme



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On 5 May, the HKMA issued a circular to share with the industry the Guidelines on the Mandatory Reference Checking (“MRC”) Scheme issued by the Hong Kong Association of Banks (“HKAB”) and the DTC Association.

## Background of MRC

- The MRC Scheme seeks to address the “rolling bad apples” phenomenon in the banking sector in Hong Kong, i.e. situations where individuals who engage in misconduct during their employment in one institution are able to obtain subsequent employment in another institution without disclosing their misconduct to the new employer. Such individuals who are not held accountable at one institution and surface at another can potentially have a higher likelihood of repeating their misconduct. This may give rise to operational, reputational, financial and other risks at the new employer institution. More broadly, “rolling bad apples” may also inflict harm on bank customers and undermine public confidence in the banking sector. Against this background, the MRC Scheme is issued.

## The MRC Scheme

- The Guidelines on the MRC Scheme issued by the industry associations provide the operational details of the MRC Scheme. In essence, AIs recruiting for certain specified positions that fall within the scope of the MRC Scheme (“Recruiting AIs”) will be required to approach the former and current AI employer(s) of a prospective employee (“Reference Providing AIs”) to request conduct-

related information covering the seven years prior to the application for such position. Misconduct information to be reported includes (i) breach of legal or regulatory requirements; (ii) incidents which cast doubt on an individual’s honesty and integrity; (iii) misconduct reports filed with the HKMA; (iv) internal or external disciplinary actions arising from conduct matters; and (v) ongoing internal investigations. Reference Providing AIs should respond within one month of the MRC request using a standard template.

- One of the underlying principles of the MRC Scheme is that misconduct matters that are deemed serious or material in nature should be reported by Reference Providing AIs, irrespective of whether or not the employment of the individual concerned was terminated for the misconduct. Recruiting AIs, while retaining the discretion and remaining responsible for their employment decisions, should document their reasons for employing an individual notwithstanding negative or inconclusive information received.

## Implementation

- The MRC Scheme is applicable to all AIs and will be implemented in phases. In Phase 1, the positions to be covered include directors, chief executives, alternate chief executives and managers as defined under the Banking Ordinance, as well as executive officers and responsible officers for securities, insurance and Mandatory Provident Fund (“MPF”) regulated activities. A review of the Scheme will be

conducted two years after the implementation of Phase 1 (i.e. in mid-2025). The findings of the review will help refine the Scheme in Phase 2, which is expected to be expanded to cover individuals licensed or registered to carry out regulated activities.

- To allow sufficient time for AIs to put in place necessary internal controls, policies and procedures, there is a 12-month preparatory period for the implementation of the MRC Scheme, i.e. AIs are expected to implement Phase 1 of the MRC Scheme by 2 May 2023.

## HKMA’s supervisory approach

- While the MRC Scheme is not introduced as a supervisory requirement, the HKMA considers that repeated failures of an AI to adhere to the requirements of the MRC Scheme may indicate potential weaknesses with its governance arrangements or internal controls and procedures. The HKMA will monitor AIs’ observance of the MRC Scheme during its ongoing supervisory efforts and may initiate follow-up actions with the AIs concerned as appropriate.

## Additional Reading

[Mandatory Reference Checking Scheme](#)

## Other Regulatory Updates

### HKMA Circular on Banking (Capital) (Amendment) Rules 2022

On 22 April, the HKMA issued a circular to inform all AIs that the Banking (Capital) (Amendment) Rules 2022 (“BCAR 2022”) were published in the Gazette. The amendments contained in the BCAR 2022 are mainly to implement the capital standard set out in the document entitled Capital requirements for banks’ equity investments in funds issued by the Basel Committee on Banking Supervision. The capital standard introduced a hierarchy of three approaches with varying degrees of risk sensitivity for setting capital requirements for banks’ equity investments in funds. The BCAR 2022 also contain an amendment to designate the Hong Kong Export Credit Insurance Corporation as a domestic public sector entity for preferential risk-weighting treatments by locally incorporated authorized institutions.

The BCAR 2022 will be tabled before the Legislative Council for negative vetting on 27 April 2022. Subject to the views of the Legislative Council, the subsidiary legislation should come into operation on 1 July 2022.

### SFC Circular on Amendments to the REIT Code in relation to Bookbuilding and Placing Activities

On 22 April, the SFC issued a circular that sets out consequential amendments to the Code on Real Estate Investment Trusts (“REIT Code”) which dovetail with the amendments to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission in relation to bookbuilding and placing activities. These amendments will be applicable to authorization applications for REIT on or after 5 August 2022.

### HKMA Circular on Launch of the Regtech Knowledge Hub

On 26 April, the HKMA launched the Regtech Knowledge Hub (“Hub”) to encourage greater sharing of Regtech adoption experience and expertise within the Regtech ecosystem in Hong Kong. The establishment of the Hub forms part of the HKMA’s two-year Regtech promotion roadmap announced in November 2020 to promote Regtech adoption.

The Hub provides an online platform for the Regtech community,

including banks and Regtech providers, to share success stories and implementation experience. Apart from sharing industry use cases, the Hub also acts as a central repository of the HKMA’s Regtech-related information, including past circulars, guidance papers, and research reports.

### HKMA Circular on Regtech Adoption Practice Guide

On 28 April, the HKMA shared the sixth issue of the Regtech Adoption Practice Guide which focuses on Artificial Intelligence-based (“AI-based”) Regtech solutions. AI can help analyse and interpret data at scale and in real-time, providing predictive insights and alerts on a timely basis for more comprehensive risk monitoring.

This practice guide provides implementation guidance to help banks plan the adoption of AI-based Regtech solutions. It offers advice on how banks can establish data and AI frameworks to address the challenges and barriers associated with AI usage.

### HKMA Circular on Temporary Protection Measures for Business Tenants (COVID-19 Pandemic) Ordinance

On 29 April, the HKMA issued a circular to remind AIs regarding the passage of the Temporary Protection Measures for Business Tenants (COVID-19 Pandemic) Bill and provided guidance on the steps that AIs should take to comply with the Business Tenants (COVID-19 Pandemic) Ordinance (“Ordinance”).

The Ordinance aims to mitigate the impact of COVID-19 on business tenants of certain premises by providing for a protection period (generally three months from the commencement of the Ordinance, which is on 1 May) within which landlords are barred from taking certain actions in respect of their tenants’ failure to pay the rent. To support landlords facing cashflow difficulties as a result of the rental enforcement moratorium, the Ordinance correspondingly provides for a period within which a lender (including an AI), which has provided a loan secured by such (tenanted) premises, is also barred from taking certain actions in respect of a repayment default where certain conditions are satisfied.

In addition to complying with the Ordinance, the HKMA also expects AIs to offer credit relief on the basis of the Pre-approved Principal Payment Holiday Scheme (PPPHS) to landlords (including corporates and individuals) encountering cashflow problem where appropriate.

### HKMA Circulars on 100% Personal Loan Guarantee Scheme

On 1 May, the Temporary Protection Measures for Business Tenants (COVID-19 Pandemic) Ordinance came into effect which provides temporary protection for business tenants in specified premises whose businesses are hard hit by the fifth wave of the COVID-19 pandemic. In this connection, the Government has announced the provision of interest-free loans of up to three times the monthly rent under the 100% Personal Loan Guarantee Scheme (“PLGS”), subject to a ceiling of \$100,000 per individual, to provide support to individual landlords affected by rental enforcement moratorium.

Starting from 6 May, the 100% PLGS will receive loan applications from individual eligible landlords affected by rental enforcement moratorium. There are 11 participating lenders for the Scheme and the application period will last until 31 October 2022.

### SFC FAQ on i) the Code of Conduct on Bookbuilding and Placing Activities in Equity Capital Market and Debt Capital Market Transactions and (ii) “Sponsor Coupling”

On 6 May, the SFC has issued a new Frequently Asked Questions series to provide guidance on the application of paragraphs 17.1A and 21 of the Code of Conduct, which sets out the standards of conduct expected of a licensed or registered person engaged in bookbuilding or placing activities in equity capital market and debt capital market transactions.

## Glossary

AI	Authorised Institutions	ICO	Initial Coin Offering
AML	Anti-Money Laundering	IFRS	International Financial Reporting Standard
BC	Basel Committee	IOSCO	International Organization of Securities Commission
BCBS	Basel Committee on Banking Supervision	IR-1	Interest Rate Risk Management
CFT	Counter-Financing of Terrorism	IRR	Interest Rate Risk
CG-1	Corporate Governance of Locally Incorporated Authorized Institutions	IRRBB	Interest Rate Risk in the Banking Book
FATF	Financial Action Task Force	LC	Licensed Corporation
FinTech	Financial Technology	LIBOR	The London Inter-bank Offered Rate
FMCC	Fund Manager Code of Conduct	MAS	Monetary Authority of Singapore
FI	Financial Institutions	MRF	Mutual Recognition of Funds
FSB	Financial Stability Board	MoU	Memorandum of Understanding
HKMA	The Hong Kong Monetary Authority	RO	Responsible Officer
IA	The Insurance Authority	RE-1	Recovery Planning
IAF	Internal Audit Function	SFC	The Securities and Futures Commission
IC-1	Risk Management Framework	SFO	Securities and Futures Ordinance
IC-2	Internal Audit Function	SPM	Supervisory Policy Manual

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The materials contained in this document were assembled in May 2022 and were based on the law enforceable and information available at that time.