

Client Alert

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SFC proposes to extend its licensing regime to trustees and custodians of public funds

Hong Kong's Securities and Futures Commission (SFC) has issued a [consultation paper](#) proposing to create a new regulatory regime for depositaries of SFC-authorized collective investment schemes (CIS). Responses to the consultation are due on 31 December 2019.

Background

Trustees and custodians of publicly offered CIS in Hong Kong are not currently subject to any specific SFC licensing requirements, despite the vital role they play in safeguarding scheme assets and conducting independent oversight. As part of the SFC's strategy to strengthen Hong Kong's position as a full service asset management centre and enhance the regulation of public funds, the SFC proposes to introduce a new regulated activity under the Securities and Futures Ordinance (SFO): Type 13 regulated activity – acting as a depositary (trustee/custodian) of a CIS ("**Type 13**").

Key Changes

Scope of Application

- Type 13 is intended to cover trustees and custodians at the top of the custodial chain. As such, a "depositary" is proposed to mean:
 - in the case of a CIS in the form of a unit trust (e.g. unit trust, real estate investment trust, pooled retirement fund), a person who is appointed as the *trustee* for that CIS pursuant to its trust deed
 - in the case of a CIS in a form other than a unit trust (e.g. open-ended fund company, mutual fund corporation), a person who is appointed pursuant to a written agreement to perform the functions of a *custodian* for that CIS
- A depositary's nominees, agents and delegates, such as a sub-custodian or the global custodian appointed by a 'top-level' trustee, will not fall within the scope of Type 13.
- As MPF-approved trustees are already subject to the Mandatory Provident Fund Schemes Authority's (MPFA) regulation, they are excluded from the Type 13 licensing requirement to the extent that their trustee services relate purely to MPF products.

Licensing

- The licensing requirement applies to any corporation carrying on a business in Type 13 as well as individuals performing any regulated function in relation to an intermediary's business of "acting as a depositary". Staff members responsible for directly supervising the conduct of the depositary's key business functions must obtain the SFC's approval as responsible officers, or the Hong Kong Monetary Authority (HKMA)'s consent as executive officers. Clerical staff members who





perform operational tasks will generally not be required to be licensed/registered for Type 13.

- Type 13 licensed corporations will also be subject to the Manager-In-Charge regime introduced by the SFC in December 2016.
- As with other types of regulated activity, the requirement to be fit and proper will apply to firms and individuals seeking to be licensed or registered for Type 13. The SFC also proposes to introduce new licensing examinations for Type 13 and impose equivalent requirements for ongoing training.

Financial Resources

Type 13 licensed corporations will be required to maintain a minimum paid-up share capital of HKD 10 million as well as a minimum liquid capital of HKD 3 million. The minimum liquid capital required may increase as a consequence of an increase in the size of the corporation's operations and liabilities.

Professional Indemnity Insurance cover

The SFC proposes to impose a requirement for Type 13 depositaries to maintain a professional indemnity insurance policy (on either a group or entity level) which provides adequate coverage for liability claims arising from breaches of duty in the course of carrying out Type 13 regulated activity.

Conduct and internal controls

Once licensed or registered, Type 13 depositaries will be subject to the SFC's supervision, or in the case of registered institutions, the HKMA's supervision, and must comply with:

- the SFO
- the SFC's codes and guidelines, including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**") and the Management, Supervision, and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission
- the existing provisions in the Product Codes¹ for the regulation of Type 13 which apply to trustees and custodians
- consequential changes to SFC codes, guidelines and subsidiary legislation

Timing and transitional arrangements

The SFC proposes to give potential Type 13 depositaries approximately 12 to 18 months to complete the licensing/registration process prior to the implementation of the Type 13 regime.

¹ Code on Unit Trusts and Mutual Funds (UT Code), the Code on Real Estate Investment Trusts (REIT Code), the Code on Pooled Retirement Funds (PRF Code) and the Code on Open-Ended Fund Companies (OFC Code)



In addition, the SFC proposes to adopt a "grandfathering" approach to bring existing staff of the depositaries within the Type 13 regime. The competence of staff applying to be responsible officers, executive officers or representatives of Type 13 depositaries during the transition period will be assessed in accordance with the academic qualification, relevant industry experience and management experience tests. However, these staff will not be required to pass the Local Regulatory Framework Papers. Instead, they will be required to complete a course of not less than five hours on the legal and regulatory framework for Type 13 conducted by a continuous professional training provider within 12 months of securing the licensing or registration approval.

Potential Impacts

If the proposed changes per the consultation paper are adopted, then the relevant depositaries which will be subject to the Type 13 licensing requirement will have to:

- review the proposed requirements in light of the new Schedule 11 of the Code of Conduct for licensed or registered persons conducting Type 13 regulated activity ("**Additional Requirements**") and establish internal control policies and procedures to meet the Additional Requirements
- procure appropriate professional indemnity insurance for Type 13 regulated activity
- in the case of depositaries of a relevant CIS authorized under the REIT Code, review and establish internal control policies and procedures to meet the additional requirements in Part II of the Additional Requirements

Next steps

The consultation is due on 31 December 2019. We will update you should there be any changes to the proposed regime after the consultation. Watch this space!

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