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Countdown to the regulatory regime for trustees and custodians of Hong Kong public funds

Jeremy Lam and Mary Nieto

The regulatory regime for depositaries of Hong Kong public funds will commence on 2 October 2024. The regime includes the requirement for trustees and custodians of Hong Kong authorised funds to be licensed by the Securities and Futures Commission (**SFC**) for a new type 13 regulated activity (**RA13**). In this article we look at which depositaries are in scope, the key dates for licensing application process and the preparatory steps that are advisable over the next few months.

Key dates

On 24 March 2023, the SFC gazetted amendments to the Securities and Futures Ordinance (**SFO**) to introduce RA13. The SFC has provided for an 18-month transitional period between the gazettal date and the commencement date of 2 October 2024. The SFC expects existing in-scope trustees and custodians to submit RA 13 licensing applications within four months of the launch of the SFC's electronic forms, which is expected in the third quarter of this year.

Scope

RA13 is an activity of providing depositary services for a relevant collective investment scheme (**CIS**) with reference to two core functions of a depositary, being (a) custody and safekeeping of scheme property and (b) oversight of the operation of the relevant CIS to ensure that it is operated in accordance with its constitutive documents. Entities will need to be licensed for RA13 if they carry on business in Hong Kong as the top-level trustee or custodian of one or more SFC-authorised CIS, excluding (i) mandatory provident fund schemes (**MPFs**) and their constituent funds; and (ii) approved pooled investment funds (**APIFs**) which are or are intended to be offered only to professional investors, employers, MPFs, occupational retirement schemes and pooling arrangements and other APIFs. APIFs that may be offered to retail investors are included, so the trustees of such APIFs will need to be licensed for RA13.

Individuals performing regulated functions for licensed depositaries will also need to be approved as executive officers, responsible officers or representatives for RA13. Regulated functions in respect of RA13 include custody operations, monitoring of investment and borrowing restrictions, fund accounting and valuation, and monitoring of subscriptions and redemptions.

Regulatory framework

Amendments to the SFO to introduce RA13 are supported by a new Schedule 11 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission. Schedule 11 is specific to RA13 and covers conduct and internal control requirements. In addition, there are amendments to other SFC codes and guidelines, such as the Code on Unit Trusts and Mutual Funds, and consequential amendments to subsidiary legislation, such as the financial resources rules. Details are available in the SFC's consultation conclusions of 24 March 2023: [Consultation Conclusions on Proposed Amendments to Subsidiary Legislation and SFC Codes and Guidelines to Implement the Regulatory Regime for Depositories of SFC-authorized Collective Investment Schemes](#).

Preparatory steps

The SFC has provided a transitional period for in-scope trustees and custodians to prepare for the commencement of the regime. Issues to consider in advance of the submission of the licensing application include:

- Substantial shareholders: ascertain the shareholding structure of the entity to be licensed and identify substantial shareholders; compile the information required by the SFC in order to review and approve the substantial shareholders.
- Organizational chart and supervision: identify who needs to be licensed as representatives, responsible officers / executive officers (**ROs**) and Managers-in-Charge; prepare CVs for the RO candidates to assess fulfilment of the SFC's competence requirements.
- RA13 business compliance: prepare gap analysis to identify required compliance infrastructures, such as those required by the Code of Conduct and in particular, the new Schedule 11 to such Code. Prepare policies and procedures.

We are currently advising a number of trustees on their impending RA13 licensing applications and are able to assist with your migration to the new regime. For existing trustees and custodians, the SFC expects submissions to be made within four months of the publications of the relevant forms in Q3, i.e. the application deadline will be a date between November 2023 and January 2024. There is much to do before then and we recommend applicants starting planning well in advance.

Expansion of eligible stocks under Stock Connect

Taylor Hui and Faye Meng

Effective from 13 March 2023, the list of eligible stocks under the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect (collectively, **Stock Connect**) has been significantly expanded. This follows the joint announcement by Hong Kong's Securities and Futures Commission and the China Securities Regulatory Commission on the further expansion of eligible stocks under Stock Connect back in December 2022.

In respect of northbound trading under Stock Connect, Shanghai Stock Exchange (**SSE**) and Shenzhen Stock Exchange (**SZSE**) released revised implementation rules on 3 March 2023, which specify the revised scope of eligible China A-Shares available to overseas and Hong Kong investors through Stock Connect. Below are some key points of the expansion:

- For the Shanghai-Hong Kong Stock Connect, the benchmark index has been expanded from SSE 180 Index and SSE 380 Index to SSE A-Share Index; the constituent stocks have been expanded from large-cap and mid-cap stocks to medium-cap and small-cap stocks listed on the SSE; and there is no longer any limitation on the number of stocks available in a single industry.
- For the Shenzhen-Hong Kong Stock Connect, the benchmark index has been expanded from SZSE Component Index and SZSE Small/Mid Cap Innovation Index to SZSE Composite Index.
- Requirements have been revised in relation to the daily average market capitalization, daily average turnover and the trading suspension ratio.

- The arrangement for initial inclusion of stocks of companies with differentiated voting rights under northbound trading has been clarified.

In respect of southbound trading, through which Mainland Chinese investors can trade stocks listed on the Stock Exchange of Hong Kong, it is worth noting that the scope of eligible stocks has been expanded to include eligible stocks of international companies primary-listed in Hong Kong.

Risk based capital requirements for insurers move closer

Scott Carnachan

The Government has introduced legislation that (i) provides the framework for risk based capital requirements for authorized insurers, (ii) amends the existing provisions relating to approval of “controllers” of authorized insurers, and (iii) makes other streamlining changes to the operation of the Insurance Ordinance.

The Insurance (Amendment) Bill 2023 (the **Amendment Bill**) was gazetted on 6 April 2023 and had its first reading in the Legislative Council on 19 April 2023. The Amendment Bill is available [here](#). The Legislative Council briefing paper summarising the Amendment Bill is available [here](#). No timing has been publicly announced for enactment of the Amendment Bill.

New categories of authorized insurers

The Amendment Bill introduces new definitions of “HK insurer”, “non-HK insurer” and “designated insurer”. A HK insurer is an authorized insurer that is incorporated in Hong Kong. A non-HK insurer is an authorized insurer that is not a HK insurer. A designated insurer is a non-HK insurer that is designated by the Insurance Authority (the **IA**) as a designated insurer.

The IA will have power to designate a non-HK insurer as a designated insurer where, in the opinion of the IA, the non-HK insurer carries on a majority of its insurance business in or from Hong Kong. A designated insurer will be subject to essentially the same requirements for capital and approval of controllers (including shareholder controllers) as a HK insurer. The appointment of new directors of a designated insurer will also need prior IA approval.

In contrast, the capital requirements for a non-HK insurer that is not a designated insurer will be limited to its Hong Kong business, determination of controllers will be by reference to its Hong Kong business and it will not need to seek prior IA approval to the appointment of new directors. A non-HK insurer that is not a designated insurer will no longer need to apply for prior IA approval of changes in its shareholder controllers. However, it will still need to notify the IA of such changes.

Risk based capital requirements

The introduction of risk based capital requirements for authorized insurers has been a long term project for the IA, first initiated in 2014. The Amendment Bill removes the existing capital requirements for authorized insurers from the Insurance Ordinance and replaces them with a framework to enable the IA to implement risk based capital requirements. Capital requirements, financial reporting requirements and requirements for valuation of assets and liabilities, will be set out in Rules made by the IA under the Insurance Ordinance.

The Amendment Bill also contains provisions requiring authorized insurers that carry on long term business to maintain separate accounts and funds in respect of certain categories of long term business. If an authorized insurer also carries on general business (i.e. is a composite insurer) then the Amendment Bill also imposes an obligation to maintain a separate fund for that part of its business that is general business.

Changes to approvals of “controllers”

The information that will need to be submitted to the IA in connection with appointment, removal or other change in controllers, together with the form and manner of submission, will be as specified by the IA. The forms that are currently set out in Schedules 2, 4, 5 and 6 of the Insurance Ordinance will no longer apply and these Schedules will be repealed.

The Amendment Bill also introduces new definitions of “majority shareholder controller” and “minority shareholder controller”.

A majority shareholder controller of an authorized insurer is a person who, alone or with an associate (as defined in the Insurance Ordinance) or through a nominee, is entitled to exercise or control the exercise of, 50% or more of the voting power at a general meeting of the insurer.

A minority shareholder controller of an authorized insurer is a person who, alone or with an associate (as defined in the Insurance Ordinance) or through a nominee, is entitled to exercise or control the exercise of, 15% or more but less than 50%, of the voting power at a general meeting of the insurer.

A person will require prior IA approval to become a majority shareholder controller of either a HK insurer or a designated insurer (other than a special purpose insurer, as defined in the Insurance Ordinance).

A person will require prior IA approval to become a minority shareholder controller of either a HK insurer or a designated insurer (other than a special purpose insurer, as defined in the Insurance Ordinance) unless, immediately before becoming a minority shareholder, the person was a majority shareholder controller of the relevant insurer.

Where a non-HK insurer is designated by the IA as a designated insurer, its majority shareholder controller (if any) and minority shareholder controllers (if any) at the time of designation will be deemed to have been approved by the IA.

A person will not require prior IA approval to become either a majority shareholder controller or a minority shareholder controller of a non-HK insurer that is not a designated insurer. However, the relevant insurer will be required to notify the IA of changes in its shareholder controllers within one month of the change taking place.

Other changes

The Amendment Bill also contains a number of other changes, including:

- Requiring authorized insurers who carry on general business to appoint an actuary, subject to the approval of the IA, to carry out valuations and submit actuarial reports on a regular basis;
- Empowering the IA to require authorized insurers to disclose certain information about the insurer to the public;
- Modifying the basis of taxation of authorized insurers on an interim basis to mitigate the effect of the changes to the capital requirements for authorized insurers (which may otherwise result in a significant one-off increase in assessable profits for certain insurers).

What should authorized insurers do now?

All authorized insurers should monitor updates from the IA on the detailed risk based capital requirements, including transitional provisions for compliance with such requirements.

All authorized insurers should review the proposed changes to the approvals of controllers and prepare to update their internal systems and controls to reflect the new requirements.

Authorized insurers incorporated outside Hong Kong should assess whether they are likely to be designated as designated insurers, and so subject to the new Hong Kong risk based capital requirements and other relevant Hong Kong regulatory requirements on their whole business.

Hong Kong's cross-border data transfer regime

Kelley Loo

Although Hong Kong's Personal Data (Privacy) Ordinance (**PDPO**) has been in force since December 1996, the specific cross-border transfer of data provisions contained in section 33, are still not yet in force. The provisions are intended to prohibit the transfer of personal data outside Hong Kong unless certain conditions are fulfilled. The framework is to ensure that data should only be transferred to jurisdictions that give a similar level of protection as provided under the PDPO.

There is still no timetable for implementation of the cross-border data transfer provisions. However, in May 2022, the Hong Kong Privacy Commissioner issued an updated Guidance Note on “Recommended Model Contractual Clauses for Cross-border Transfer of Personal Data”. The Guidance Note includes two sets of recommended model contractual clauses (**RMCs**) to cater for different scenarios in cross-border data transfers. It is important to be note that many of the general protections of the PDPO also apply in the context of cross-border data transfers and the RMCs are consistent with existing data privacy requirements under the PDPO, including the six Data Protection Principles that govern, amongst others, the purpose and manner of collection of personal data, use and disclosure of personal data.

Although the Guidance Note is not legally binding, it should be considered as best practice, and compliance with the guidance by a business will be taken into account when investigating any suspected or alleged breach of the PDPO. It is recommended that businesses incorporate the RMCs (which have been prepared as free-standing clauses) into agreements with third parties on cross-border transfers of data. It should be emphasised that the sharing or transferring of personal data from a business to its parent, subsidiary, affiliated, related or other company within the same group of companies, whether located in or outside of Hong Kong, will still be regarded as “transferring out” of data and, as such, will still need to comply with the general requirements of the PDPO.

Businesses should also be aware that, while the RMCs appear similar to the Standard Contractual Clauses recently published pursuant to China’s Personal Information Protection Law (**PIPL**), they are separate regimes and compliance with PIPL will need to be considered independently. The Guidance Note is a reminder for businesses to review their contracts on transfer of personal data to check for compliance with the guidance and the other requirements of the PDPO.

Please contact Deacons Intellectual Property Department for further information.

Challenges under China’s complex privacy compliance framework

Dora Si and Venus Yim

In recent years, China has intensified its data protection efforts. Apart from the Cybersecurity Law and the Data Security Law, the Personal Information Protection Law (**PIPL**) also came into force in 2021. This was rapidly followed by a series of implementing regulations and guidelines that fleshed out the substantive requirements.

Heightened requirements under the PIPL

PIPL introduced a more comprehensive but complex legal regime for privacy compliance, applying to the processing of personal information of individuals in the Mainland China, even if the processing activities are conducted *outside Mainland China*.

Informed consent - Apart from the general requirement that personal information should be processed based on the principles of lawfulness, necessity and good faith, the PIPL stipulates that *informed consent* shall be obtained from individuals *before* their personal information is collected, used, or otherwise handled. The exception is where the processing of the personal information is necessary for any of the five lawful bases set out in Article 13 of the PIPL:

1. The conclusion or performance of a contract.
2. The performance of statutory responsibilities or obligations.
3. The response to a public health emergency, or the protection of life, health or property of a natural person.
4. News reporting for the public interest and the processing of personal information is within a reasonable scope.
5. Where the personal information disclosed legally in public, or by the individuals themselves, is processed within a reasonable scope.

No regulatory or administrative guidance has been published yet on how these “exceptions to consent” will be implemented. Therefore, it is recommended to seek appropriate consent from individuals.

Separate consent - In certain special circumstances, a “separate”, informed consent will be required including when:

- sensitive information (such as financial accounts) of an individual is processed;
- personal information is transferred outside Mainland China;
- personal information is provided to, or shared with, another data processor (*including intra-group entities*);
- personal information is made available in public.

Personal information protection officer - A “personal information protection officer” will need to be appointed if the volume of personal information being processed reaches a prescribed threshold, to supervise the processing activities and the implementation of protective technical and organisational measures. Data processors without a local presence, processing personal information outside Mainland China, shall set up special agencies or appoint representatives within the territory to handle relevant data protection matters.

Personal information protection impact assessment - A personal information protection impact assessment (**PIA**) is a prerequisite for processing sensitive information, using personal information in automated decision-making, providing personal information to another data processor or disclosing the same to the public, and cross-border data transfer.

Cross-border data transfer mechanisms

Apart from fulfilling the consent and PIA requirements, businesses wishing to carry out cross-border transfer of personal information outside Mainland China must also satisfy *at least one* of the conditions:

	Available mechanism	Criteria/ eligibility
1	Passing an official security assessment conducted by the Cyberspace Administration of China (CAC)	Mandatory in certain prescribed circumstances: (1) the data processor is a “critical information infrastructure operator”; (2) “important” data is transferred; (3) the personal information of more than 1 million people is being processed; or (4) cumulatively, the personal information of more than 100,000 people, or the sensitive personal information of more than 10,000 people, has been transferred outside Mainland China since 1 January of the preceding year.
2	Obtaining a personal information security certification	Applicable to cross-border transfer of personal information which does not trigger the application of the official assessment, such as intra-group cross-border transfer of personal information between subsidiaries, or associated companies of multinational companies. The certification applicant should be a PRC legal entity; branches and representative offices do not qualify.
3	Entering into a contract adopting the Standard Contractual Clauses with the data recipient outside China and recording it with the CAC	Applicable where the compulsory security assessment by the CAC is not triggered.

Official security assessment - The Measures for Security Assessment of Cross-border Data Transfer issued by the CAC (**Security Assessment Measures**) took effect on 1 September 2022 and set out detailed guidelines. Cross-border data transfer activities to which the Security Assessment Measures apply should have been rectified by the end of February 2023. Those who qualify for official assessment, but failed to do so, are deemed to be in breach of the law but there have been no announcements on the enforcement details yet. In any case, since it is possible to apply for an official assessment anytime, relevant data processors should still apply and not conduct any cross-border transfers without passing the CAC's assessment.

While the Security Assessment Measures appear to be more relevant to data-heavy businesses with a huge demand for overseas personal information transfer, all data processors are generally recommended to regularly monitor the type and volume of personal information processed. Compliance with the relevant requirements as and when needed will avoid possible disruption to business. Generally, the security assessment results are valid for two years, but re-application for assessment is necessary if there is a continued need for cross-border transfer, or there are material changes to the transfer activities.

Personal information security certification - The revised version of the Technical Specification for Certification of Cross-Border Transfers of Personal Information issued on 8 November 2022 clarifies that the certification mechanism applies to all cross-border personal transfers, except where the CAC's official security assessment mechanism is triggered. The certification is voluntary and, currently, the China Cybersecurity Review Technology and Certification Centre is the only body accredited for certification. Since the certification will only be valid for three years once granted, a data processor wishing to continue with cross-border data transfers, should apply for a fresh certification within six months before expiry.

Standard contract regime - On 24 February 2023, the CAC issued the long-awaited Measures for the Standard Contract for Cross-Border Transfer of Personal Information (**Measures**), together with the template Standard Contract. The Measures marked the official implementation of the standard contract regime and provides eligible companies with another compliance option; where the data processing activities do not trigger an official assessment, data processors may choose to enter into a contract with the data recipient outside China adopting the standard contract clauses (**SCC**). Notably, the Measures explicitly prohibit data processors from manipulating the transfers, such as breaking down the amount of personal information processed, to circumvent the CAC security assessment regime.

Under the Measures, the SCC must be adopted but the parties may agree on other contractual terms, provided that they do not contradict the SCC. The SCC extend the obligations under the PIPL to overseas data processors by contractual means, and allows data subjects to exercise rights against the overseas data processors as a third-party beneficiary.

Furthermore, data processors are required to file a copy of the signed contract, together with the PIA report, with the local CAC *within 10 days* from its effective date.

The Measures will take effect from **1 June 2023** with a six-month grace period for data processors to rectify any non-compliant data transfer. Given that the final deadline for compliance is less than nine months away, affected companies should take immediate steps to negotiate / finalize contractual terms, prepare the PIA report and appoint a representative in China for filing the documentations with the CAC.

What's next?

With the implementing rules for all three cross-border data transfer mechanisms now in place, increased enforcement actions against non-compliant transfer of personal database outside of China can be expected. Businesses should conduct self-assessments, to identify the nature and volume of personal data involved in cross-border transmissions, and formulate their privacy compliance programs.

Where an official security assessment is not triggered, businesses should consider either voluntary certification or recording a standard contract, to facilitate cross-border transfer activities. Although standard contract recordal has clear advantages in terms of time and cost efficiencies, businesses should review the SCC's compatibility with other data processing obligations applicable to them pursuant to other contractual arrangements or privacy legislation, and harmonize where appropriate.

Please contact Deacons Intellectual Property Department for further information.

Hong Kong SFC licensing and compliance hints – April 2023

Jennifer Baccanello

Reminder to private equity firms of the SFC's stance on licensing

In the SFC's [Circular to private equity firms seeking to be licensed \(Circular\)](#) dated 7 January 2020, it was made clear that depending on the business activities of private equity (PE) firms, they may be required to be licensed by the Securities and Futures Commission (SFC) ([link](#) to our analysis of the Circular).

The SFC's recently published [Quick Reference Guide to Licensing Requirements](#) for PE firms provides useful and simplified information on the typical licences required for PE firms and explains issues relating to co-investment activities, incidental exemptions, as well as the approach that the SFC takes when deciding whether an individual meets the competency requirements to become licensed as a responsible officer.

If you are operating a PE firm, our dedicating licensing and compliance team can assist you by:

- assessing your current business activities and determining whether any of the licensing exemptions apply;
- if you are not required to be licensed, providing advice on how to operate in a way that will ensure you are not in breach of the regulatory requirements;
- if you are required to be licensed:
 - preparing a comprehensive licensing application to the SFC;
 - drafting policies and procedures covering your regulated business activities; and
 - assisting with ongoing regulatory and compliance support.

Waiver of annual licensing fees

Annual licensing fees for intermediaries and licensed individuals have been waived by the SFC for the period 1 April 2023 to 31 March 2024.

Recent publications

[Hong Kong Stock Exchange proposes to make climate disclosures mandatory for all listed companies](#)

[Alert: Repeal of provisions relating to COVID-19 vaccination under Employment Ordinance](#)

[Time to protect your trade marks in the metaverse – a Hong Kong perspective](#)

[New liabilities for shareholders and directors under draft amendments to China's Company Law](#)

[New Beijing employment interpretation: Employers can be fined up to RMB50,000 for gender discrimination in employment – Punishment Benchmark Table \(Involving Women's Rights and Interests Protection Law\) of the Beijing Human Resources and Social Security Administration](#)

[New requirement on airlines to provide travellers' personal data to immigration department before arriving into Hong Kong](#)

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