



**SECURITIES AND
FUTURES COMMISSION**
證券及期貨事務監察委員會

Consultation Paper on the Proposed Regulatory Regime for Depositaries of SFC-authorized Collective Investment Schemes

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Personal information collection statement

1. This Personal Information Collection Statement (PICS) is made in accordance with the guidelines issued by the Privacy Commissioner for Personal Data. The PICS sets out the purposes for which your Personal Data¹ will be used following collection, what you are agreeing to with respect to the SFC's use of your Personal Data and your rights under the Personal Data (Privacy) Ordinance (Cap. 486) (PDPO).

Purpose of collection

2. The Personal Data provided in your submission to the SFC in response to this consultation paper may be used by the SFC for one or more of the following purposes:
 - (a) to administer the relevant provisions² and codes and guidelines published pursuant to the powers vested in the SFC;
 - (b) in performing the SFC's statutory functions under the relevant provisions;
 - (c) for research and statistical purposes; or
 - (d) for other purposes permitted by law.

Transfer of personal data

3. Personal Data may be disclosed by the SFC to members of the public in Hong Kong and elsewhere, as part of the public consultation on this consultation paper. The names of persons who submit comments on this consultation paper, together with the whole or part of their submissions, may be disclosed to members of the public. This will be done by publishing this information on the SFC website and in documents to be published by the SFC during the consultation period or at its conclusion.

Access to data

4. You have the right to request access to and correction of your Personal Data in accordance with the provisions of the PDPO. Your right of access includes the right to obtain a copy of your Personal Data provided in your submission on this consultation paper. The SFC has the right to charge a reasonable fee for processing any data access request.

Retention

5. Personal Data provided to the SFC in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the SFC's functions.

¹ Personal Data means personal data as defined in the Personal Data (Privacy) Ordinance.

² The term "relevant provisions" is defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571) and refers to the provisions of that Ordinance together with certain provisions in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32), the Companies Ordinance (Cap. 622) and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615).



Enquiries

6. Any enquiries regarding the Personal Data provided in your submission on this consultation paper, or requests for access to Personal Data or correction of Personal Data, should be addressed in writing to:

Data Privacy Officer
Securities and Futures Commission
35/F, Cheung Kong Center
2 Queen's Road Central
Hong Kong

Proposed regulatory regime for depositaries of SFC-authorized collective investment schemes

Executive summary

1. Depositaries³ (trustees and custodians) of publicly offered collective investment schemes (CIS) have important obligations to safeguard scheme assets and conduct independent oversight. It is of paramount importance that they are subject to prudential and effective regulation, particularly where retail investors' interests are at stake.
2. Since the global financial crisis, the protection of fund assets has been the subject of heightened attention around the world. Regulatory authorities in many overseas jurisdictions have reviewed or reformed their safe custody regimes. The International Organization of Securities Commissions (IOSCO) has issued recommendations to clarify, modernise and further develop standards for the custody of assets managed under CIS.
3. Trustees and custodians of public funds in Hong Kong are currently not subject to any specific licensing regime for, or direct on-going regulatory supervision of, their trustee or custodial function for public funds. The lack of a specific, direct regulatory handle gives rise to practical difficulties in ensuring appropriate regulation and supervision of these entities in their provision of trustee and custodial services to public funds.
4. In view of this, as part of our asset management strategy to strengthen Hong Kong as an international, full service asset management centre and to 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 (RA 13) – acting as a depositary (trustee/custodian) of an SFC-authorized CIS.
5. The key proposals for RA 13 set out in this consultation paper have been formulated after soft consultation with industry participants and relevant stakeholders, including various industry associations, other financial market regulators in Hong Kong as well as the SFC's Products Advisory Committee.
6. The SFC invites comments on the proposals. A consultation conclusions paper will be published as soon as practicable after the end of the consultation period.

³ This refers to the entities which are at the top of the custodian chain in a CIS. See paragraph 15 for further discussion.

Background

7. Since the global financial crisis, major overseas markets have enhanced their safe custody regimes for funds to augment investor protection. Many major overseas regulators now have a direct regulatory handle over entities which provide trustee, custodial or depositary services for, at a minimum, public funds. For example:
 - (a) In Europe, the Undertakings for the Collective Investment in Transferable Securities (UCITS) regime⁴ requires a single depositary to be appointed for each fund, which must be (i) a national central bank; (ii) a credit institution authorised by its national competent authority; or (iii) a legal entity authorised by its national competent authority to carry on depositary activities. There are similar requirements under the Alternative Investment Fund Managers Directive (AIFMD)⁵;
 - (b) In the United Kingdom, “establishing, operating or winding up a collective investment scheme (including acting as trustee of a unit trust scheme or depositary of a CIS other than a unit trust scheme)” is a regulated activity which requires authorization⁶;
 - (c) In Singapore, all trustees of CIS authorized by the Monetary Authority of Singapore (MAS) for public offering must be approved by the MAS⁷; and
 - (d) In Australia, the operation of registered managed investment schemes for public offering by responsible entities (which have dual functions as both the trustee and fund manager) is a financial service which requires licensing⁸.
8. Internationally, IOSCO’s Objectives and Principles of Securities Regulation⁹ provides that a regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who operate a CIS. IOSCO’s final report on Standards for the Custody of Collective Investment Schemes’ Assets¹⁰ (IOSCO Paper) sets out recommendations for the physical and legal integrity of CIS assets.
9. In comparison, the current regulatory regime in Hong Kong with respect to trustees and custodians of public funds¹¹ is patchy:
 - (a) CIS offered to retail investors in Hong Kong are authorized under section 104 of the SFO¹² and the product codes, ie, the 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

⁴ Articles 22 and 23 of UCITS V.

⁵ Article 21 of AIFMD.

⁶ Section 22 and Schedule 2 to the Financial Services and Markets Act 2000 in the UK.

⁷ Sections 286(2) and 289 of the Securities and Futures Act (Cap. 289) in Singapore.

⁸ Section 601FA of the Corporations Act 2001 in Australia.

⁹ Version dated May 2017, Principle 24.

¹⁰ Issued in November 2015.

¹¹ Other than mandatory provident fund products, discussed further in paragraph 19.

¹² Unless one of the exemptions under section 103 of the SFO applies.

Companies (OFC Code)¹³ (collectively, the Product Codes). The Product Codes set out, amongst other things, provisions relating to the eligibility of persons who may act as trustee or custodian of the CIS seeking to be authorized – these include banks and trust companies. The Product Codes also set out obligations which trustees and custodians are expected to discharge. However, as the provision of trustee or custodial services for CIS is not a regulated activity, the SFC is unable to directly supervise these trustees and custodians.

- (b) Under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO), trustees of mandatory provident fund (MPF) schemes are approved by the Mandatory Provident Fund Schemes Authority (MPFA). However, the MPFA's regulatory power is limited to the trustee's operations with respect to MPF schemes and constituent funds thereunder, but not other funds (for example SFC-authorized unit trusts) which engage the same trustee.
 - (c) The Hong Kong Monetary Authority (HKMA) adopts a risk-based supervisory approach to authorized institutions (AIs). It may oversee the trustee or custodian business of an AI (or a subsidiary of a locally incorporated AI) as part of its supervision of the AI's business as a whole.
 - (d) Similarly, the Insurance Authority (IA) also adopts a risk-based supervisory approach to authorized insurers. Where there are non-regulated entities (including entities which are trustees or custodians) within the group of an authorized insurer, the IA adopts an indirect supervisory approach by ensuring that they do not pose any operational, legal, reputational or solvency risks to the authorized insurer concerned.
10. In recent years, we have come across a number of cases involving deficiencies in the internal control systems of some trustees and custodians. Whilst the SFC was able to seek redress so that investors did not suffer material losses, we were unable to discipline or take other enforcement action against the trustee or custodian.
11. Accordingly, to better align with international practice and enhance the protection of investors in public funds, we propose to create a new regulated activity to bring trustees and custodians of public funds under the SFO licensing, supervision and enforcement regime applicable to intermediaries.

¹³ Open-ended fund companies which are offered to the public in Hong Kong (ie those which are registered and authorized under section 104 of the SFO) and their key operators (including the custodians) are required to comply with all applicable requirements under the UT Code as well as Section I of the OFC Code.

Proposals

Proposed scope

12. We propose to introduce a new type of regulated activity under Schedule 5 to the SFO, acting as a depositary of a CIS which is authorized by the SFC under section 104 of the SFO (relevant CIS). This will be RA 13.
13. We propose to use the term “depositary” to refer to an intermediary¹⁴ licensed or registered for RA 13. Comments from the industry on earlier proposals suggested that using the term “trustee or custodian” in the proposed description of RA 13, even though it is currently used in the UT Code, may create confusion as to the range of entities and responsibilities covered. The use of the term “depositary” is proposed to address some of these concerns.
14. Some industry participants expressed the view that the proposals should not impose the same requirements on trustees and custodians because they have different legal obligations. For example, whilst a trustee has fiduciary duties under trust law, custodians do not. We would like to clarify that the proposed obligations are regulatory obligations and are in addition to any legal obligations which a depositary may have due to its legal structure, eg, a depositary that is a trustee would need to comply with the proposed regulatory requirements as well as its legal obligations as trustee of the relevant CIS.
15. The proposed scope of RA 13 is intended to cover “top-level” trustees and custodians, ie, the entity at the top of the custodial chain. For a relevant CIS structured in the form of a unit trust, this entity will be the trustee. For a relevant CIS structured in any other form such as an open-ended fund company (OFC) authorized under the SFO or a mutual fund corporation, it will be the global or top custodian. 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 proposed scope of RA 13.
16. Whilst “top-level” trustees and custodians may delegate their functions to third parties, the responsibilities of an RA 13 depositary with respect to these functions remain with the depositary. This is in line with IOSCO recommendations and the regulatory regimes and practices of major jurisdictions. The “top-level” entities have the responsibility to exercise reasonable care, skill and diligence in the selection and monitoring of delegates. They should ensure that their accountability to the relevant CIS and investors is not diminished and their obligations under relevant requirements are discharged, whether or not any of their functions are delegated.
17. It is proposed that a “depositary” would mean:
 - (a) in the case of a relevant CIS structured in the form of a unit trust, a person who is appointed as the trustee in respect of such CIS pursuant to the trust deed which constitutes or governs such CIS; and
 - (b) in the case of a relevant CIS structured in a form other than a unit trust, a person (by whatever name called) who is appointed to perform the functions of a custodian in respect of such CIS pursuant to a written agreement entered into between the person and such CIS.

¹⁴ Under Part 1 of Schedule 1 to the SFO, an “intermediary” means a licensed corporation or a registered institution.

18. A relevant CIS would be one which is authorized by the SFC under section 104 of the SFO, ie, unit trusts, mutual fund companies, real estate investment trusts, pooled retirement funds authorized under the SFO and open-ended fund companies registered and authorized under the SFO¹⁵, but excluding MPF products.
19. Given that MPF-approved trustees are already subject to the MPFA's regulation and supervision, to minimise regulatory duplication we propose to exclude them from the scope of RA 13 insofar as the trustee services relate only to MPF products. We intend to achieve this by excluding the following MPF products¹⁶ from the meaning of "relevant CIS" : –
- (a) A registered scheme or its constituent fund as defined in section 2(1) of the MPFSO (MPF schemes); and
 - (b) An approved pooled investment fund (APIF)¹⁷ as defined in section 2 of the Mandatory Provident Fund Schemes (General) Regulation¹⁸ (MPFSGR) which is or is intended to be offered only to:
 - (i) professional investors;
 - (ii) employers as defined in section 2(1) of the MPFSO;
 - (iii) MPF schemes;
 - (iv) occupational retirement schemes as defined in section 2(1) of the Occupational Retirement Schemes Ordinance¹⁹ (ORSO);
 - (v) pooling agreements as defined in section 2(4) of the ORSO; or
 - (vi) other APIFs (referred to as Non-retail APIFs in this consultation paper).
20. The intended result is that a trustee which acts only for pure MPF products will not need to be licensed or registered for RA 13. On the other hand, if a trustee acts for both the above MPF products and other CIS authorized by the SFC (eg, a public unit trust), it will be subject to the supervision of both the MPFA (in respect of the MPF products²⁰) and the SFC (in respect of any SFC-authorized CIS which are not MPF products)²¹.
21. However, the carve-out will not include APIFs which may be offered to both MPF schemes and directly to retail investors (Retail APIFs) as these funds should be

¹⁵ RA 13 will not be applicable to any SFC-authorized CIS (such as an investment-linked assurance scheme) where no trustee or custodian is required to be appointed in respect of such CIS under the relevant Product Code.

¹⁶ MPF products are approved by the MPFA and authorized by the SFC under section 104 of the SFO and pursuant to the SFC Code on MPF products. The MPFSGR also requires that pooled investment funds invested under MPF schemes to be authorized by the SFC.

¹⁷ Under existing MPF legislation, it appears that there is no requirement that a trustee of an APIF must be an MPF-approved trustee, although in practice, currently, all 10 existing APIF trustees are also MPF-approved trustees. Section 17(2)(g), Part 4 of Schedule 1 to the MPFSGR provides that, among other things, a trustee of an APIF must comply with such of the requirements of the MPFSGR as relate to an MPF-approved trustee, in so far as those requirements are relevant to the APIF.

¹⁸ Cap. 485A, Laws of Hong Kong.

¹⁹ Cap. 426, Laws of Hong Kong.

²⁰ Although MPFA's supervision over an MPF-approved trustee's operation does not strictly extend to Non-retail APIFs, on the basis that all trustees of Retail and Non-retail APIFs are currently also MPF-approved trustees and Non-retail APIFs are not offered directly to retail investors, we are of the view that Non-retail APIFs should be included in the carve-out as well.

²¹ Where the trustee is an authorized institution, it will have to be registered for RA 13 as a registered institution subject to the supervision of the HKMA as the frontline regulator.

distinguished from pure MPF products. Pure MPF products may only be offered to MPF schemes, employers and employees or professional investors, and on this basis, they are not required to comply with many of the SFC's regulations which apply to retail funds (eg, provisions in the UT Code). There are fewer investor protection concerns in respect of these MPF products because they are already regulated by the MPFA. On the other hand, Retail APIFs may be offered directly to retail investors and therefore requirements which apply to all retail funds should apply equally to Retail APIFs, including the proposed RA 13.

Questions

- Question 1: Do you have any comments on the proposed scope of RA 13?
- Question 2: Do you have any comments on the proposed exemption for trustees which only act for MPF products?
- Question 3: Do you think any other exemptions are necessary? If so, what are they and why are they necessary?

Licensing and conduct requirements

Licensing requirements

22. Similar to other types of regulated activity, Part V of the SFO requires any corporation carrying on a business in RA 13 (ie, acting as a depositary) to be licensed by or registered with the SFC. Accordingly, the proposed licensing scope at the firm level would capture all “top-level” trustees and custodians which operate in Hong Kong in respect of relevant CIS as discussed in paragraphs 15 to 19.
23. In line with the existing licensing regime, we propose that individuals performing any regulated function²² in relation to an intermediary's business of “acting as a depositary” would be required to be licensed representatives or relevant individuals²³ accredited to the intermediary. Specifically, we would expect that staff members who perform more than a clerical²⁴ role in a business function directly relating to the depositary's discharge of its regulatory obligations set out in the Product Codes²⁵ should seek to be licensed or registered. For example, in the case of a depositary of a relevant CIS authorized under the UT Code, these business functions may include custody operations, monitoring of investment and borrowing restrictions, fund accounting and valuation, and monitoring of subscriptions and redemptions of the CIS (where applicable). Staff members of the depositary responsible for directly supervising the conduct of these business functions

²² Under section 113 of the SFO, “regulated function” in relation to a regulated activity “carried on as a business by any person means any function performed for or on behalf of or by arrangement with the person relating to the regulated activity, other than work ordinarily performed by an accountant, clerk or cashier.

²³ Relevant individuals who perform regulated functions in relation to regulated activities for registered institutions are not required to be licensed or registered with the SFC. However, their names have to be entered in the register maintained by the HKMA under section 20 of the Banking Ordinance if they are to perform regulated activities.

²⁴ Clerical roles generally refer to the performance of routine tasks following established procedures, such as document filing and data input. These roles generally do not require staff to make business decisions.

²⁵ Including 4.5 of the UT Code, 4.1A and 4.2 of the REIT Code and the relevant provision in the PRF Code which will be subject to public consultation for the PRF Code review exercise.

are also expected to obtain the SFC's approval as responsible officers or the Monetary Authority (MA)'s consent as executive officers²⁶ for RA 13.

24. We recognise that some depositary services are relatively operational in nature and it is commonplace for a depositary to assign operational tasks to clerical staff. We take the view that clerical staff members who perform operational tasks are generally not required to be licensed or registered under this regime.
25. Staff members of internal corporate functions of an RA 13 depositary, such as human resources, information technology, finance and accounting, legal and compliance, will not be required to be licensed or registered.
26. The Manager-In-Charge regime introduced by the SFC in December 2016 will also apply to corporations licensed for RA 13²⁷.
27. Under the current licensing framework, a person applying for a licence or registration to carry on a regulated activity must satisfy the SFC that he or she is fit and proper to be so licensed or registered. Registered institutions should ensure that their relevant individuals are fit and proper to be so engaged. The existing licensing criteria will apply equally to firms and individuals seeking to be licensed or registered for RA 13, with new licensing examinations for RA 13 to be introduced. In this connection, the Guidelines on Competence will be amended to set out the recognised industry qualifications and the local regulatory framework papers applicable to RA 13. The SFC will work with the Hong Kong Securities and Investment Institute on the development of licensing examinations.
28. Among other obligations, persons licensed or registered for RA 13 will be required to comply with the same requirements for ongoing training set out in the Guidelines on Continuous Professional Training as persons licensed or registered for other types of regulated activity. The SFC will amend such guidelines as appropriate.
29. Regarding the transitional arrangements applicable to existing industry participants, please refer to paragraphs 44 to 47.

Questions

- Question 4: Do you have any comments on the proposed licensing scope applicable to staff members of RA 13 depositaries?
- Question 5: Do you agree with the proposal to apply the existing licensing criteria to persons licensed or registered for RA 13? If not, please explain your views.

²⁶ Individuals who act as executive officers of registered institutions are required to obtain the MA's consent under section 71C of the Banking Ordinance.

²⁷ Please refer to the [circular](#) issued by the SFC on 16 December 2016 regarding "Measures for Augmenting the Accountability of Senior Management" and the related [Frequently Asked Questions](#) published by the SFC. Registered institutions should refer to the [circular](#) issued by the HKMA on 16 October 2017 regarding "Management Accountability at Registered Institutions" and the related [Frequently Asked Questions](#) published by the HKMA.

Financial resources requirements

30. In line with other types of regulated activity, RA 13 licensed corporations must maintain adequate financial resources under the Securities and Futures (Financial Resources) Rules (Financial Resources Rules)²⁸. We propose:
- (a) a minimum paid-up share capital of HK\$10,000,000 which is similar to the current requirement under the Product Codes²⁹; and
 - (b) a minimum liquid capital of HK\$3,000,000.

The minimum liquid capital required may increase as a consequence of an increase in the size of the corporation's operations and liabilities.

Question

Question 6: Do you agree with the amounts proposed for the financial resources requirements for RA 13 licensed corporations under the Financial Resources Rules? If not, please explain your views.

Professional indemnity insurance requirement

31. Separately, we propose to impose a non-statutory requirement³⁰ for RA 13 depositaries to maintain a professional indemnity insurance policy which provides adequate coverage³¹ for claims for liability arising from breaches of duty in the course of carrying on its RA 13 business. This proposal, which will form part of the proposed requirements applicable to RA 13 depositaries set out in Appendix B, is in line with a similar requirement for licensed or registered fund managers under the Fund Manager Code of Conduct (FMCC)³².

Question

Question 7: Do you agree with the proposed requirement for RA 13 depositaries to maintain a professional indemnity insurance policy with respect to their RA 13 business? If not, please explain your views.

²⁸ Cap 571N, Laws of Hong Kong

²⁹ Trustees or custodians are currently required to have minimum paid-up share capital and non-distributable capital reserves of HK\$10,000,000 under the UT Code, PRF Code and REIT Code respectively, and where a trustee or custodian's paid-up share capital and non-distributable capital reserves are less than HK\$10,000,000, it may rely on a standing commitment or undertaking from its holding company. The SFC does not propose to allow an RA 13 firm to rely on its holding company's standing commitment or undertaking where it cannot meet the financial resources requirements because to do so would be inconsistent with the treatment of all other types of regulated activity.

³⁰ This proposal should not be confused with the statutory insurance requirement under the Securities and Futures (Insurance) Rules (Cap 571AF, Laws of Hong Kong) (Insurance Rules). We do not propose to subject RA 13 licensed corporations to the insurance requirement under the Insurance Rules and will make amendments to the Insurance Rules (by specifying an insured amount of "nil" for RA 13) to make this clear.

³¹ Coverage may be taken out at the group or entity level, so long as it is adequate.

³² See section 1.2(e) of the Fund Manager Code of Conduct.

Conduct and internal controls requirements

32. Once licensed or registered, RA 13 depositaries and individuals must comply with the applicable legal and regulatory requirements, such as the SFO, and 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 (Internal Control Guidelines). In addition to these requirements, RA 13 depositaries will be expected to continue to meet the existing provisions in the Product Codes which apply to trustees and custodians.
33. Since (a) trustees and custodians of SFC-authorized CIS are already familiar with the requirements under the Product Codes and (b) differences in these requirements cater for the specific nature of each type of product, the creation of new requirements for RA 13 depositaries covering all CIS may create duplication and confusion. Hence we believe it is more practical to rely on the existing provisions in the Product Codes and make appropriate amendments where necessary. For reference, a list of the existing general obligation under the relevant Product Codes is set out in Appendix A to this consultation paper.
34. Under the existing UT Code³³, trustees or custodians of SFC-authorized CIS are required to engage independent auditors to review their internal controls and systems and submit internal control reports reviewed by auditors to the SFC annually, unless a trustee or custodian is prudentially regulated and supervised by an overseas supervisory authority which is acceptable to the SFC. Specific terms of reference for the internal control reports are set out in Appendix G to the UT Code. There are similar requirements for trustees of PRFs under the PRF Code³⁴.
35. With the introduction of RA 13, depositaries of relevant CIS will be subject to the SFC's supervision, or in the case of registered institutions, the HKMA's supervision as the frontline regulator. We therefore propose to remove the current requirement to submit the annual internal control reports to the SFC. However, Appendix G to the UT Code, which was subject to a recent public consultation, provides updated and detailed guidance on the internal controls depositaries should have in place. These provisions are CIS-specific and not currently contained in the Code of Conduct or Internal Control Guidelines. Accordingly, we see value in retaining these requirements and propose a new schedule 11 to the Code of Conduct (Schedule 11) to set them out.
36. The proposed Schedule 11 is at Appendix B³⁵. It will be the responsibility of the senior management of an RA 13 depositary to exercise professional judgment in designing suitable internal controls and systems and ensure that these are adequately, effectively and properly implemented.

³³ See section 4.1 of and Appendix G to the UT Code.

³⁴ See section 6.1 of and Appendix E to the PRF Code.

³⁵ In view of the specific nature of REITs and PRFs, the proposed Schedule 11 contains some modifications (in Part II of the Schedule for REITs and various paragraphs in Part I for PRFs) to apply the Schedule's requirements to depositaries of REITs and PRFs.

Questions

- Question 8: Do you agree with the proposal to rely on existing provisions in the Product Codes for the regulation of RA 13 depositaries? If not, please explain your views.
- Question 9: Do you agree with the proposals (i) to remove the requirement for the submission of annual internal control reports and (ii) for the provision of additional internal control requirements in the proposed Schedule 11 to the Code of Conduct? If not, please explain your views.
- Question 10: Do you have any comments on the proposed Schedule 11? For requirements which are oversight functions of the depositary under the proposed Schedule 11, the term “relevant operator(s)” has been used to refer to the party or parties which should be subject to the depositary’s oversight. Do you have any comments on the use of this term? We would welcome any input regarding which specific party should appropriately be subject to the depositary’s oversight.

Consequential changes to SFC codes, guidelines and subsidiary legislation

SFC codes and guidelines

37. With respect to the UT Code, in addition to the proposed removal of the internal control report requirement and Appendix G, Chapter 4 will need to be amended so that a trustee or custodian of a CIS for which authorization is requested must be either an RA 13 depositary or an overseas bank or entity which is prudentially regulated and supervised in its home market by an authority acceptable to the SFC³⁶.
38. In respect of the REIT Code, amendments will be made to reflect the introduction of RA 13 (eg, to amend the eligibility requirements for REIT trustees).
39. In respect of the OFC Code, amendments will be made so that the eligibility requirements for custodians of publicly-offered OFCs will be aligned with those under the revised UT Code (as referred to in paragraph 37), while the eligibility requirements for custodians of privately-offered OFCs³⁷ would be subject to a separate consultation exercise.
40. Similarly, consequential changes to the PRF Code will be needed to reflect the introduction of RA 13 (eg, to amend the eligibility requirements for PRF trustees and remove Appendix E). The SFC is currently reviewing the PRF Code under a separate exercise, the key objectives of which are to modernise and enhance the requirements for SFC-authorized PRFs and align them with the applicable requirements under the UT Code (taking into account the unique features of PRFs).
41. During our soft consultation sessions, some industry participants suggested that there may be some overlap between the responsibilities of fund managers under the FMCC and those of depositaries. They believe this may not be necessary after the introduction

³⁶ See section 4.2(d) of the UT Code.

³⁷ These are OFCs which are registered but not authorized under the SFO.

of RA 13. For example, paragraphs 4.3.2 and 4.3.3 of the FMCC require fund managers who are responsible for funds' overall operations to formulate custody arrangements with due skill, care and diligence and monitor them on an ongoing basis. Under the Product Codes, depositaries are required to oversee and monitor certain activities of fund managers³⁸. It was suggested that the responsibilities of the two parties should be clarified. We are of the view that the fund manager and the trustee or custodian each has its own responsibilities in respect of the formulation and monitoring of custody arrangements and should perform checks and balances against the other's performance of such obligations (at a minimum, for public funds). This is also consistent with the principles in the IOSCO Paper³⁹. We therefore do not believe any clarification is necessary.

42. In addition to the Product Codes, consequential amendments will also be needed to other SFC codes and guidelines, including the Code of Conduct, the Guidelines on Competence and the Guidelines on Continuous Professional Training as mentioned in paragraphs 27 and 28.

Question

Question 11: Do you agree with the proposed consequential amendments to the Product Codes? Are there additional amendments you believe to be appropriate? Please explain your views.

Subsidiary legislation

43. Consequential amendments to various subsidiary legislation under the SFO may be needed for the introduction of RA 13. A preliminary list is set out in Appendix C. We will issue a second consultation with indicative drafts of the amendments (if any) after the consultation conclusions paper for this exercise.

Question

Question 12: Do you agree with the list of subsidiary legislation which may be subject to amendment? Would amendments be necessary to any other subsidiary legislation in order for RA 13 to be introduced? Please explain your views.

³⁸ For example, requirements under sections 4.5(c), (d), (e) and (f) of the UT Code.

³⁹ See for example, the definition of "responsible entity" under the IOSCO Paper, which states that "the responsibilities for the performance of the functions of the CIS and compliance with legal and regulatory framework could rest with both the management company and the trustee" (which will include a custodian for the purpose of RA 13).

Proposed implementation and transitional arrangements

44. The SFC will publish a consultation conclusions paper in due course. As mentioned in paragraph 43 above, any consequential amendments to subsidiary legislation will be subject to further public consultation as well as the legislative process.
45. A period of around 12 to 18 months from the date of gazettal of the notice published by the Financial Secretary to amend Schedule 5 of the SFO (Gazettal Date) will be provided for potential RA 13 depositaries and their related staff members to complete the licensing or registration process prior to the implementation of the RA 13 regime. Prospective applicants (including firms and individuals) are expected to submit their applications to the SFC, or to the HKMA as the case may be, together with supporting documents within two months from the Gazettal Date. Applicants should co-operate with the SFC, and with the HKMA as the case may be, in responding to requisitions in a timely manner.
46. Whilst the SFC will give priority to processing applications submitted by existing depositaries and their staff during the transitional period, a delay in submitting a licence or registration application or in responding to a regulator's requisitions would lengthen the application process and may result in disruption to the applicant's business operations.
47. Given that the depositaries of SFC-authorized CIS have a long history of operation in Hong Kong and are managed by experienced staff, we propose to adopt a "grandfathering" approach to bring existing staff of these depositaries within the RA 13 regime. The competence of staff applying to be responsible officers, executive officers or representatives of RA 13 depositaries during the transitional 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 RA 13 conducted by a continuous professional training provider within 12 months of securing licensing or registration approval. This will be in addition to fulfilling the normal Continuous Professional Training requirements⁴⁰.

Question

Question 13: Do you agree with the proposed transitional arrangements? If not, please explain your views.

⁴⁰ As referred to in the Guidelines on Competence.



Seeking comments

48. The SFC welcomes comments from the public and the industry on the proposals in this consultation paper. The feedback received will help finalise our views on how RA 13 will be regulated. Please submit comments to the SFC in writing by no later than 31 December 2019.

Appendix A

Existing general obligations⁴¹ under the relevant product codes⁴² applicable to depositaries

UT Code

4.5 The trustee/custodian must:

- (a) (i) take into its custody or under its control all the property of the scheme and hold it in trust for the holders (in the case of a unit trust) or the scheme (in the case of a mutual fund corporation) in accordance with the provisions of the constitutive documents;

Note: With respect to property of the scheme which by nature cannot be held in custody, the trustee/custodian shall maintain a proper record of such property in its books under the name of the scheme.

- (ii) register cash and registrable assets in the name of or to the order of the trustee/custodian;
- (iii) be liable for the acts and omissions of nominees, agents and delegates in relation to assets forming part of the property of the scheme;

Note: Nominees, agents and delegates that are appointed for the custody and/or safekeeping of the property of the scheme shall be subject to prudential regulation and supervision, unless otherwise accepted by the Commission. The Commission must be satisfied with the overall custodial/safekeeping arrangement put in place to provide proper and adequate safeguards for the property of the scheme, having taken into account, among others, applicable local legal and regulatory requirements.

- (iv) segregate the property of the scheme from the property of:
- (1) the management company, investment delegates and their respective connected persons;
 - (2) the trustee/custodian and any nominees, agents or delegates throughout the custody chain; and
 - (3) other clients of the trustee/custodian and nominees, agents or delegates throughout the custody chain, unless held in an omnibus account with adequate safeguards in line with international standards and best practices to ensure that the property of the scheme is properly recorded with frequent and appropriate reconciliations being performed; and

⁴¹ Please refer to the relevant Product Code for further details and definitions of any term defined in such Product Code.

⁴² The SFC is currently reviewing the PRF Code under a separate exercise and the relevant conduct requirements for depositaries will be added subject to public consultation. It is currently expected that such conduct requirements for PRF depositaries will be enhanced to align with those under the UT Code as far as applicable.

- (v) put in place appropriate measures to verify ownership of the property of the scheme;
 - (b) take reasonable care to ensure that the sale, issue, repurchase, redemption and cancellation of units/shares effected by a scheme are carried out in accordance with the provisions of the constitutive documents;
 - (c) take reasonable care to ensure that the methods adopted by the management company in calculating the value of units/shares are adequate to ensure that the sale, issue, repurchase, redemption and cancellation prices are calculated in accordance with the provisions of the constitutive documents;
 - (d) carry out the instructions of the management company in respect of investments unless they are in conflict with the provisions of the offering or constitutive documents or this UT Code;
 - (e) take reasonable care to ensure that the investment and borrowing limitations set out in the constitutive documents and the conditions under which the scheme was authorized are complied with;
 - (f) issue a report to the holders to be included in the annual report on whether in the trustee/custodian's opinion, the management company has in all material respects managed the scheme in accordance with the provisions of the constitutive documents; if the management company has not done so, the respects in which it has not done so and the steps which the trustee/custodian has taken in respect thereof;
 - (g) where applicable, take reasonable care to ensure that unit/share certificates are not issued until subscription moneys have been paid;
 - (h) take reasonable care to ensure that the cash flows of the scheme are properly monitored;
 - (i) exercise reasonable care, skill and diligence in the selection, appointment and ongoing monitoring of nominees, agents and delegates which are appointed for the custody and/or safekeeping of scheme's property [see 4.5(a)(iii)]; and be satisfied that the nominees, agents and delegates retained remain suitably qualified and competent on an ongoing basis to provide the relevant services;
 - (j) fulfil such other duties and requirements imposed on it as set out in this UT Code; and exercise due skill, care and diligence in discharging its obligations and duties appropriate to the nature, scale and complexity of the scheme; and
- Note: In discharging its obligations, trustee/custodian shall make reference to the minimum requirements on the terms of reference for the review of internal controls and systems of trustee/custodian as set out in Appendix G.*
- (k) establish clear and comprehensive escalation mechanisms to deal with potential breaches detected in the course of discharging its obligations and report material breaches to the Commission in a timely manner.

Note: The trustee/custodian is expected to (i) update the management company and report to the Commission (either directly or via the management company) any material issues or changes that may impact its eligibility/capacity to act as trustee/custodian of a scheme and (ii) inform the Commission promptly of any material breach of this UT Code and applicable provisions of the Handbook with respect to the scheme that has come to its knowledge, which has not been otherwise reported to the Commission by the management company.

REIT Code

4.1A The trustee has the fiduciary duty to hold the assets of a scheme in trust for the benefit of the holders, and to oversee the activities of the management company for compliance with the relevant constitutive documents of, and regulatory requirements applicable to, the scheme. This includes ensuring that all investment activities carried out by the management company are in line with the investment objective and policy of a scheme and its constitutive documents, and are in the interests of the holders.

4.2 The trustee shall:

- (a) (i) exercise all due diligence and vigilance in carrying out its functions and duties and in protecting the rights and interests of the holders;

Note: The trustee may seek the opinion or advice of an independent professional adviser concerning matters in the administration of the scheme if it deems appropriate.

- (ii) ensure that all the assets of the scheme are properly segregated and held for the benefit of the holders in accordance with the provisions of the constitutive documents; and
- (iii) be liable for the acts and omissions of its nominees and agents in relation to assets forming part of the property of the scheme;
- (b) take all reasonable care to ensure that the sale, issue, repurchase and cancellation of units effected by a scheme are carried out in accordance with the provisions of the constitutive documents;
- (c) appoint from time to time a Principal Valuer who meets the qualification requirements set out in Chapter 6 to value the real estate of the scheme and to produce valuation reports with respect to the real estate of the scheme in accordance with Chapter 6;
- (d) cause a valuation of any of the real estate of the scheme to be carried out if it, or the management company, reasonably believes that such valuation is appropriate;
- (e) carry out the instructions of the management company in respect of investments unless they are in conflict with the provisions of the offering or constitutive documents or this Code or under general law;

- (f) take all reasonable care to ensure that the investment and borrowing limitations set out in the constitutive documents and the conditions under which the scheme was authorised are complied with;
- (g) take all reasonable care to ensure that no real estate is acquired or disposed of by or on behalf of the trustee until the trustee has obtained a recent valuation report of a property valuer appointed and instructed in writing by the trustee;

Note: The effective date as at which the real estate is valued shall not be more than three months before the date on which the relevant circular is issued (if the transaction requires holders' approval) or the date of the sale and purchase agreement (if the transaction does not require holders' approval).

- (h) take all reasonable care to ensure that all transactions carried out by or on behalf of a scheme are conducted at arm's length and that connected party transactions are carried out in accordance with Chapter 8;

Note: Where the trustee is in doubt as to whether a transaction is a connected party transaction, it shall require such transaction to be subject to the provisions of Chapter 8.

- (i) issue a report to the holders, to be included in the annual report, on whether in the trustee's opinion, the management company has in all material respects managed the scheme in accordance with the provisions of the constitutive documents; if the management company has not done so, the report shall specify respects in which it has not done so and the steps which the trustee has taken in respect thereof;
- (j) take all reasonable care to ensure that unit certificates are not issued until subscription monies have been paid;
- (k) take all reasonable care to ensure that a scheme has proper legal title to the real estate owned by the scheme, as well as to the contracts (such as property contracts, rental agreements, joint venture or joint arrangement agreements, and any other agreements) entered into on behalf of the scheme with respect to its assets and that each such contract is legal, valid and binding and enforceable by or on behalf of the scheme in accordance with its terms;

Note: The real estate shall have good marketable title.

- (l) take all reasonable care to ensure that the management company arranges adequate property insurance and public insurance coverage in relation to the real estate of a scheme;
- (m) take all reasonable care to ensure that the net asset value per unit of a scheme is calculated as and when an annual valuation report is issued by the valuer for the relevant period, and that such net asset value shall be published in the annual report;
- (n) require that the management company report to the trustee as soon as reasonably practicable any breaches of the provisions in this Code and the

trustee shall inform the Commission of such breaches, where appropriate, upon notification by the management company; and

- (o) be responsible for the appointment of the board of directors of all special purpose vehicles held by a scheme.

Appendix B

Proposed new Schedule 11 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

Schedule 11 Additional requirements for licensed or registered persons conducting Type 13 regulated activity

Introduction

1. This Schedule sets out additional requirements (Additional Requirements) that apply to a person licensed or registered for Type 13 regulated activity, namely acting as a depositary of a relevant CIS (a Depositary).
2. A Depositary should establish and implement written internal control policies and procedures to meet the Additional Requirements. Where a requirement is an oversight function of a Depositary, the Depositary should perform ex-post controls and assessment of processes and procedures that are under the responsibility of (i) the management company; (ii) the relevant CIS; or (iii) a delegate or an appointed third party. In the case where an activity or matter which is required to be under the oversight of a Depositary pursuant to any applicable laws and regulations is in fact carried out by the Depositary in practice, it should assume primary obligation for such activity or matter.
3. The internal controls and systems designed to meet the Additional Requirements may vary from firm to firm taking into account the size of the operation of the firm, the nature and volume of transactions undertaken, the dealing arrangements and the nature of the assets of the relevant CIS.
4. In this Schedule:
 - (a) a “relevant CIS” means a collective investment scheme which has been authorized by the Commission under section 104 of the SFO and pursuant to the relevant Product Code(s), other than any collective investment scheme authorized by the Commission solely pursuant to the SFC Code on MPF Products;
 - (b) a “Product Code” means any of the following codes administered by the Commission, as may be amended and updated from time to time:
 - (i) the Code on Unit Trusts and Mutual Funds (UT Code);
 - (ii) the Code on Open-Ended Fund Companies (OFC Code)⁴³;
 - (iii) the Code on Real Estate Investment Trusts (REIT Code); and
 - (iv) the Code on Pooled Retirement Funds (PRF Code);

⁴³ Open-ended fund companies offered to the public in Hong Kong (public OFCs) (ie those which are registered and authorized under section 104 of the SFO) are authorized pursuant to both the UT Code and the OFC Code. Also, pursuant to the OFC Code, public OFCs and their key operators (including the custodians) are required to comply with all applicable requirements under the UT Code as well as Section I of the OFC Code.

[General note: The PRF Code is currently being reviewed under a separate exercise and therefore all provisions relating to PRFs in this draft Schedule may be further revised to align with the discussion and proposal under the PRF Code review exercise which will be subject to a public consultation.]

- (c) a “REIT” means a real estate investment trust which is authorized by the Commission under section 104 of the SFO and pursuant to the REIT Code;
 - (d) a “PRF” means a pooled retirement fund (which may comprise various investment portfolio(s)) which is authorized by the Commission under section 104 of the SFO and pursuant to the PRF Code;
 - (e) references to “management company” in the case of a PRF are to the management company that is appointed for that PRF and/or any of the management companies appointed for any of the investment portfolio(s) under such PRF (as the case may be) in accordance with the PRF Code; whereas in the case of all other relevant CIS, references to “management company” are to the management company appointed for that relevant CIS and/or any sub-fund thereunder in accordance with the relevant Product Code; and
 - (f) references to “relevant operator(s)” are to other parties involved in the operation of a relevant CIS, which may include a management company, the board of directors of a relevant CIS, a transfer agent, administrator and registrar.
5. Unless otherwise stated, terms used in this Schedule shall have the same meaning as defined or used in the relevant Product Code(s).

Part I

Depository of a relevant CIS authorized under the UT Code or the PRF Code

Management and supervision

6. Communication with the management company of a relevant CIS

A Depository should communicate with the management company in an effective and timely manner in the course of discharging its function(s) and obligation(s) with respect to a relevant CIS. A Depository should:

- (a) promptly report to the management company (i) actual material breaches of applicable legal and regulatory requirements which may have impact on the Depository’s carrying on of its regulated activities; (ii) issues that may lead to material breaches of applicable legal and regulatory requirements which may have an impact on the Depository’s carrying on of its regulated activities and (iii) matters that may affect its ability to discharge its functions or obligations under the constitutive documents with respect to the relevant CIS. The Depository should implement rectification and remedial actions, involve and coordinate with the management company in respect of such breaches or matters reported;

Note: Where a delegate or third party is engaged to carry out the operations and functions of the Depositary, the Depositary is expected to have an effective arrangement in place with the delegate or third party to enable the Depositary to comply with this requirement.

- (b) notify the management company of material exceptions to its business continuity plan which are identified during regular tests; and
- (c) upon the activation of its business continuity plan, promptly communicate with the management company the extent of services to be provided to the CIS.

7. Delegation

- (a) Where the operations and functions of a Depositary are performed by delegates or third parties (such as a custodian, sub-custodian, administrator, transfer agent and registrar), the Depositary should have proper oversight over such delegate or third party to enable the Depositary to be satisfied that the delegate or third party is suitably qualified and competent to provide the relevant service. The Depositary should have written internal control policies and procedures for:
 - (i) the selection of a delegate or third party to perform any function or operation of the Depositary, including an assessment of their competence, regulatory and financial status, capabilities and internal controls and systems in discharging their delegated functions or operations;
 - (ii) the ongoing monitoring (including a regular review) of such delegates or third parties to be satisfied that:
 - (1) the delegated functions or operations are performed in compliance with relevant legal and regulatory requirements and the constitutive documents; and
 - (2) effective internal controls and systems have been established and maintained by the delegates or third parties in carrying out the delegated functions or operations; and
 - (iii) addressing actual or potential conflicts of interests arising from the appointment and oversight of delegates or third parties.
- (b) The Depositary should establish an appropriate contingency plan in relation to the engagement of delegates or third parties, including actions and measures to be taken on breaches and solvency matters as well as other issues related to them.
- (c) Although a delegate or third party may be engaged to assume the operations and functions of a Depositary, the responsibilities and obligations shall remain with the Depositary.

Operational controls and compliance

8. Record keeping

A Depositary should ensure its record keeping policies are in compliance with applicable legal and regulatory requirements as well as the constitutive documents of the relevant CIS.

9. Oversight of the management company

A Depositary should have oversight of the management company to ensure that it has in all material respects managed the relevant CIS in accordance with the provisions of the constitutive documents of the relevant CIS.

Note: In the case of a PRF, where a management company is appointed for the PRF and/or any investment portfolio thereunder, a Depositary should have oversight of the relevant management company to ensure that it has in all material respects managed the PRF and/or the relevant investment portfolio in accordance with the provisions of the constitutive documents of the relevant CIS and the PRF Code.

10. Subscription and redemption

A Depositary should:

- (a) have oversight of the relevant operator(s) to ensure that:
 - (i) subscription and redemption transactions are processed on a timely basis;
 - (ii) subscription and redemption orders are carried out in accordance with the provisions of the constitutive documents of the relevant CIS; and
 - (iii) unit or share certificates (where appropriate) are issued and cancelled in a timely manner;
- (b) have oversight of the relevant operator(s) to ensure that reconciliation of subscription and redemption is performed (e.g. subscription or redemption orders are reconciled with the proceeds received or paid and the number of units issued or cancelled);
- (c) have oversight of the relevant operator(s) to ensure that the frequency of reconciliation conducted is consistent with the flow of subscriptions and redemptions; and
- (d) have oversight of the relevant operator(s) to ensure it has maintained proper documentation and records of the reasons for (i) suspension of dealing of units or shares of the relevant CIS and (ii) any suspension of calculation of valuation, price or net asset value of the relevant CIS, including the consultation process and the communication between the Depositary and the management company.

Note: For a PRF, where no management company is appointed for the PRF or any investment portfolio thereunder, the Depositary should assume primary

obligation (as opposed to performing an oversight function) in respect of such PRF and/or investment portfolio, as the case may be, for the obligations set out under paragraph 10 above in accordance with the PRF Code.

11. Valuation/price/net asset value calculation monitoring

A Depositary should:

- (a) have oversight of the relevant operator(s) to ensure that the methodology adopted to calculate the net asset value per unit or share for each type of investments held by the relevant CIS (including illiquid assets) is in accordance with the provisions of the constitutive documents of the relevant CIS;
- (b) have oversight of the relevant operator(s) to ensure that the calculation of the net asset value of the relevant CIS, including interest income, dividend income and fee expenses, is accurate;
- (c) have oversight of the relevant operator(s) to ensure that the use of the fair value adjustments for valuing different types of assets of the relevant CIS, including the circumstances which trigger the use of fair value adjustments is in accordance with the provisions of the constitutive documents of the relevant CIS, and that the governance structure and the review process for the fair value adjustments established by the management company (in consultation with the Depositary) are appropriate;
- (d) establish a clear and comprehensive escalation mechanism for any error or exception in the pricing of the units or shares of the relevant CIS, including informing the management company of any pricing error or exception which has come to the attention of the Depositary and reporting such error or exception to the Commission in a timely manner in accordance with the relevant Product Codes, or ensuring that such error or exception is so reported to the Commission by the management company. The Depositary should also work together with the management company to ensure that any pricing error or exception is dealt with, including ensuring that there are appropriate compensation arrangements to the relevant CIS and/or relevant unit or share holders; and
- (e) have oversight of the relevant operator(s) to ensure that it has maintained proper recording of interest income, dividend income and other corporate actions in relation to each relevant CIS.

Note: For a PRF, where no management company is appointed for the PRF or any investment portfolio thereunder, the Depositary should assume primary obligation (as opposed to performing an oversight function) in respect of such PRF and/or investment portfolio, as the case may be, for the obligations set out under paragraph 11 above in accordance with the PRF Code.

12. Distribution payment monitoring

A Depositary should have oversight of the relevant operator(s) to ensure that:

- (a) distribution calculations are carried out in accordance with the provisions of the constitutive documents of the relevant CIS; and

- (b) distribution payments are timely, complete and accurate.

13. Cash flow monitoring

A Depositary should:

- (a) implement proper procedures and controls in opening any bank account for the relevant CIS; and where any bank account for the relevant CIS is opened by the management company in the name of the relevant CIS or the management company itself, the Depositary should have oversight to ensure that the relevant CIS/management company has implemented proper procedures and controls in opening any such bank account;
- (b) ensure that prior written consent has been granted by the Depositary and kept in the case where cash is placed with the management company, investment delegates, directors of a relevant CIS, which is in mutual fund structure, or any of their connected person(s) in accordance with the provisions of the constitutive documents of the relevant CIS;
- (c) have oversight of the relevant operator(s) to ensure that controls to address conflicts of interests have been adopted, including oversight on the relevant cash management policy of the management company, where cash is placed with the entities mentioned in the relevant Product Code(s);
- (d) have oversight of relevant operator(s) to ensure that the receipt of subscription proceeds and payment of redemption proceeds are properly deposited into or withdrawn from the bank account of the relevant CIS; and
- (e) identify cash flows which are inconsistent with the operations of the relevant CIS.

Note: For a PRF, where no management company is appointed for the PRF or any investment portfolio thereunder, the Depositary should assume primary obligation (as opposed to performing an oversight function) in respect of such PRF and/or investment portfolio, as the case may be, for the obligations set out under paragraph 13 above in accordance with the PRF Code.

14. Investment monitoring

A Depositary should:

- (a) carry out the instructions of the management company of the relevant CIS with post-trade verifications in relation to investment limitations and restrictions to ensure compliance with the provisions of the offering and constitutive documents of the relevant CIS and the relevant Product Code(s);
- (b) have oversight of the relevant operator(s) to ensure that it has complied with the investment and borrowing limits set out in the offering and constitutive documents of the relevant CIS and the conditions under which the CIS was authorized;
- (c) review the accuracy of the management company's investment records;

- (d) have oversight of the relevant operator(s) to ensure that transactions are settled, and ensure that exceptions are detected and followed up, all in a timely manner;
- (e) have oversight of the relevant operator(s) to ensure that the counterparties of the transactions (e.g. brokers or financial institutions of a transaction) are on the authorized list of the relevant CIS;
- (f) have oversight of the relevant operator(s) to ensure that the margin requirement for different types of investment are complied with; and
- (g) verify daily mark-to-market value on collateral and conduct reconciliation of reports provided by counterparties with regard to the collateral.

15. Custody and safeguarding of assets

In respect of each relevant CIS, a Depositary should:

- (a) assess and manage custody risk with adequate organisational arrangements to minimise the risks of loss of the assets of the relevant CIS;
- (b) unless the assets of a relevant CIS are held in an omnibus client account with adequate safeguards in line with international standards and best practices to ensure that the assets of the relevant CIS are properly recorded with frequent reconciliations, segregate the assets of each relevant CIS from the assets of:
 - (i) the management company, investment delegate and their respective connected persons;
 - (ii) the Depositary and any nominees, agents or delegates throughout the custody chain; and
 - (iii) other relevant CIS and clients of the Depositary and its or their nominees, agents or delegates throughout the custody chain;
- (c) properly register the assets of the relevant CIS in the name of or to the order of the Depositary;
- (d) properly safeguard the assets of the relevant CIS;
- (e) obtain sufficient and reliable information and conduct verification of ownership of assets of the relevant CIS;
- (f) maintain comprehensive, up-to-date and accurate records of assets of the relevant CIS, including cash and assets that cannot be held in custody;
- (g) ensure cash reconciliation is carried out on a daily basis; and
- (h) ensure payments and asset transfers on behalf of the relevant CIS are properly authorized in accordance with the constitutive documents of the relevant CIS.

Note: Where the relevant payments or asset transfers need not be authorized by the Depositary, the Depositary should have proper oversight of the

management company to ensure that it has properly authorized or has obtained the relevant authorization.

16. Connected party transactions entered into by or on behalf of the relevant CIS

Any reference to “connected party transactions” in Part I of this schedule refers to “transactions with connected persons” in the relevant provisions under the UT Code and the PRF Code respectively.

A Depositary should:

- (a) ensure that there are proper controls adopted by the relevant CIS and have oversight of the relevant operator(s) to ensure that it has adopted proper controls in respect of connected party transactions of the relevant CIS; and
- (b) ensure prior written consent has been granted by the Depositary for any transaction between the relevant CIS and the entities mentioned in the relevant Product Code(s) are executed at the arm’s length and in the best interest of the relevant CIS, and that the consent is supported by proper documentation of the justifications for the approval of the transaction.

17. Handling different classes of investors fairly

A Depositary should have oversight of the relevant operator(s) to ensure that different classes of investors are treated fairly under the control framework of the management company, such as the putting in place by the management company of control procedures to ensure accuracy in the calculation of the net asset value of a relevant CIS with multiple classes in accordance with the constitutive documents and the valuation and procedures established by the management company.

18. Professional indemnity insurance

A Depositary should maintain adequate professional indemnity insurance cover commensurate with its business.

Part II

Depositary of a relevant CIS authorized under the REIT Code

Introduction

19. Where applicable, a Depositary of a relevant CIS authorized under the REIT Code should observe the requirements set out under Part I of this Schedule with modifications as set out below.

Note: An SFC-authorized REIT is a closed-ended fund which invests primarily in real estate. In view of its particular nature and the specific requirements set out in the REIT Code, some of the requirements in Part I of this Schedule may not be applicable to the Depositary of a REIT.

Requirements in Part I of this Schedule which apply to the Depositary of a REIT with modifications

20. The following requirements in Part I of this Schedule apply to the Depositary of a REIT where applicable with modifications set out below:

(a) Cash flow monitoring and cash reconciliation

Under the REIT Code, the management company has the obligation to manage the cash flows of a REIT. In place of the specific requirements under paragraphs 13 and 15(h) of Part I of this Schedule, the Depositary of a REIT should oversee the cash flow management activities of the management company for compliance with all applicable legal and regulatory requirements.

(b) Custody and safeguarding of assets

As part of its duty under paragraph 15 of Part I of this Schedule, the Depositary of a REIT should ensure the safe custody of all title documents of the real estate owned by the REIT as part of the assets of the REIT, including safeguard of the title documents, maintenance of an accurate and complete record of all title documents and monitoring of custody arrangement to minimise the risk of loss of title documents.

(c) Connected party transactions

Any reference to “connected party transactions” in this Schedule refers to “connected party transactions” as defined under the REIT Code.

The requirements under paragraph 16(b) of Part I of this Schedule do not apply to a Depositary of a REIT. Under the REIT Code, there are specific requirements applicable to connected party transactions, including the circumstances under which an opinion by the Depositary of a REIT would be required. The Depositary of a REIT should ensure compliance with all of its obligations in respect of connected party transactions under the REIT Code and the constitutive documents of the REIT.

Subsidiary legislation proposed to be amended

Legislation
SFO Schedule 5 Part 1 (Regulated activities)
SFO Schedule 5 Part 2 (Definitions)
Financial Resources Rules
Securities and Futures (Insurance) Rules
Securities and Futures (Client Money) Rules
Securities and Futures (Client Securities) Rules
Securities and Futures (Accounts and Audit) Rules
Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules
Securities and Futures (Keeping of Records) Rules