

## New regulatory requirements to protect client assets adopting a standardized acknowledgement letter

The Securities and Futures Commission of Hong Kong (the “**SFC**”) had published a circular titled “New Measure to Protect Client Assets” on 8<sup>th</sup> July 2019 (the “**Circular**”) to introduce new regulatory requirements to be followed by the intermediaries (i.e. licensed corporations and registered institutions) (the “**Intermediaries**”) when they are in possession or control of client assets in addition to the regulatory requirements under Paragraph 11 of the Code of Conduct<sup>1</sup>.

The reason for introduction of new regulatory requirements is that it has come to the SFC’s awareness that, in some cases, the standard terms and conditions entered into between the Intermediaries and the authorized institutions (i.e. licensed banks in Hong Kong) (the “**Als**”) applicable to the segregated accounts in the name of the Intermediaries established with the Als (the “**Client Asset Accounts**”) (whether current, deposit or securities accounts consisting of accounts for (i) holding client money, (ii) client securities and (iii) non-repledged clients’ securities collateral<sup>2</sup>) contain provisions empowering the Als to have a right of set-off or lien with respect to the client assets under the Client Asset Accounts. The SFC takes a view that such provisions are fundamentally inconsistent with the requisite standard of protection afforded to client assets under the Code of Conduct expected of the Intermediaries.

In order to intensify the safeguarding of client assets, a standardized acknowledgement letter (the “**Acknowledgement Letter**”) should be adopted and duly signed by both the Intermediaries and the Als and the Acknowledgement Letter shall include the following key provisions:-

- the notification of purpose clauses;
- the no-recourse clause; and
- the conflict clauses.



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<sup>1</sup> Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

<sup>2</sup> Not applicable to the Intermediaries’ accounts that hold clients’ securities collateral repledged (with clients’ authority) by the Intermediaries to the Als for obtaining financial accommodation from the Als.

The SFC further elaborates that the above clauses align with long-standing efforts by global regulators to protect investors and are similar to requirements imposed by regulators in other major jurisdictions.

For details of the above clauses, please refer to the Acknowledgement Letter template annexed to the Circular.

It should be noted that the “no-recourse clause” in the Acknowledgement Letter template provided by the SFC prohibits recourse against client assets in the Client Asset Accounts provided that, in case of an issuer’s default, clawback by the AIs of prepaid dividends or interest in respect of the issuer’s securities would not be considered as recourse against client assets for the purposes of new requirements. For the avoidance of doubt, the “no-recourse clause” does not apply to any recourse against assets provided by legislation or court order.

The Acknowledgement Letter template is self-explanatory that, in case of any conflict between the Acknowledgement Letter and any other agreement between the parties in connection with the Client Asset Accounts, the provisions of the Acknowledgement Letter shall prevail.

In order to comply with the above regulatory requirement, the Intermediaries should prepare and sign the Acknowledgement Letters in accordance with the template provided by the SFC, and then obtain countersignatures from the applicable AIs.

The Intermediaries are required to have the countersigned Acknowledgement Letters in place before depositing any client money or securities into any new Client Asset Accounts. The transition period for implementing this new regulatory requirement shall expire on **31<sup>st</sup> July 2020**, where the SFC expects the countersigned Acknowledgement Letters are in place for all of the Client Asset Accounts (whether newly opened or already established accounts).

This explanatory summary is not, and should not be regarded as, a legal advice. Should you have any enquiries, please seek specific advice from legal advisers.

23<sup>rd</sup> July 2019