



# Briefing on Regulation of Exempt Persons under the SFO

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# Structure of briefing

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1. Securities & Futures Ordinance
  - Effects on exempt persons
  - Regulatory requirements
2. Supervision
3. Investigation
4. Powers of intervention & proceedings
5. Way forward

# Securities and Futures Ordinance





# Securities and Futures Ordinance

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- ◆ Enacted in March 2002
- ◆ Implementation date to be announced before year-end
- ◆ Consolidates and modernizes 10 existing ordinances governing securities & futures markets
- ◆ Leaves detailed requirements to subsidiary legislation
- ◆ 37 rules to be gazetted from 29 November to 13 December 2002



# Layout of Securities and Futures Ordinance

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- ◆ Part II –the SFC
- ◆ Part III – Regulating the market operators
- ◆ Part IV – Regulating the offer of investment
- ◆ Parts V-VII – Regulating intermediaries
- ◆ Part VIII-X – Monitoring/disciplining intermediaries and listed companies
- ◆ Part XI – Appeals



# Layout of Securities and Futures Ordinance

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- ◆ Part XII – Investor Compensation Fund
- ◆ Part XIII-XIV – Taking action against market misconduct
- ◆ Part XV – Disclosure of interests in listed companies
- ◆ Part XVI – Miscellaneous
- ◆ Part XVII – Repeals and related provisions
- ◆ 10 Schedules

# Key licensing new initiatives

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Under the new single licence regime,  
licensed corporations and  
registered institutions may  
conduct any combination of  
9 regulated activities.



# Regulated activities

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Type 1: dealing in securities

Type 2: dealing in futures contracts

Type 3: leveraged foreign exchange trading

Type 4: advising on securities

Type 5: advising on futures contracts

Type 6: advising on corporate finance

Type 7: providing automated trading services

Type 8: securities margin financing

Type 9: asset management

## Effect on exempt persons

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- ◆ AFI would be deemed to be registered institutions when non-AFI would be deemed to be licensed corporations.
- ◆ Both must forthwith comply with applicable rules and regulations, subject to exceptions.

## Exempt dealers

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Deemed to be licensed for

- ◆ RA1 (dealing in securities)
- ◆ RA4 (advising on securities)
- ◆ RA6 (corporate finance)
- ◆ RA9 (asset management)\*

\* *subject to the condition that the corporation does not manage a portfolio of futures contracts*

# Exempt investment advisers

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Deemed to be licensed for

- ◆ RA4 (advising on securities)
- ◆ RA6 (corporate finance)
- ◆ RA9 (asset management)\*

\* *subject to the condition that the corporation does not manage a portfolio of futures contracts*

# Deemed licensed representatives

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- ◆ are grandfathered for the competence requirements
- ◆ will cease to be deemed if they cease to act for the regulated activity for their accredited principals
- ◆ Must apply a new licence if they change accreditation

- ◆ For individuals other than deemed licensed representatives, they must comply with competence requirements when they apply.
- ◆ Competence tests for directors and representatives

# Test of competence for directors

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- ◆ Possess degree in a financial discipline or obtain a pass in recognized industry qualifications not more than 3 years prior to date of application
- ◆ Pass one of the recognized local regulatory framework papers not more than 3 years prior to date of application
- ◆ 3 years relevant industry experience over past 6 years; and
- ◆ 2 years proven management skill and experience

# Parts governing intermediaries

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- ◆ Part V on licensing and registration
- ◆ Part VI on capital requirements, client assets, records and audit relating to intermediaries
- ◆ Part VII on business conduct, etc of intermediaries
- ◆ Part VIII on supervision and investigations
- ◆ Part X on powers of intervention & proceedings

## Part VII/VIII /X

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- ◆ section 169 - power to make codes, guidelines (non-statutory)
- ◆ section 180 - supervision powers
- ◆ sections 182/3 - investigations
- ◆ section 204 to 214 - powers of intervention & proceedings



# Key business of conduct requirements

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- ◆ Code of Conduct (incl. Client Identity Rule Policy)
- ◆ Management, Supervision & Internal Control Guidelines
- ◆ Guidance Notes Regarding Money Laundering
- ◆ Guidance Note on Internet Regulation
- ◆ Fund Manager Code of Conduct
- ◆ Corporate Finance Adviser Code of Conduct

## Effect of non-compliance

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- ◆ In any proceedings under the SFO before any court, the Code shall be admissible in evidence, and if any provision set out in the Code appears to the court to be relevant to any question arising in the proceedings, it shall be taken in account in determining the question.
- ◆ The SFC shall consider whether such non-compliance tends to reflect adversely on the person's fitness and properness.

# Supervision



# Intermediaries Supervision

- ◆ On-site
  - Routine
  - Special
  - Theme
- ◆ Off-site

always adopting a risk-based approach

## Supervision powers

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Authorized person may, at any reasonable time, for the purpose of ascertaining compliance (past, present and likely) by an intermediary or associated entity (“firm”),

- (a) enter into its premises

## Supervision powers (Cont'd)

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(b) inspect and make copies or otherwise record details of any record/document relating to

- the business conducted by the firm;
- transaction carried out by a related corporation of the intermediary or associated entity; or
- any transaction/activity which was undertaken in the course of, or which may affect, the business conducted by firm

## Supervision powers (Cont'd)

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- (c) make the inquiries of the intermediary, associated entity, related corporation or any other person, whom the authorized person has reasonable cause to believe has information relation to, or is in possession of, any record or document referred to in subsection (1)(b), concerning
- such record or document
  - any transaction or activity which was undertaken in the course of, or which may affect, the business conducted by the intermediary or associated entity

# Definition of “related corporation”

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- ◆ Where 2 or more corporations shall be regarded as related corporations of each other if one of them is
  - the holding company of the other;
  - a subsidiary of the other; or
  - a subsidiary of the holding company of the other.

# Definition of “related corporation” (Cont’d)

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- ◆ When an individual
  - controls the composition of the board of directors of one or more corporations;
  - controls more than half of the voting power at general meetings of one or more corporations;  
or
  - holds more than half of the issued share capital of one or more corporations.

## Supervision powers (Cont'd)

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Authorized person may, in exercising his power under subsection 1(b) or (c), require the intermediary, associated entity, related corporation, and other person, to give access to any record/document within the specified time and at the specified place and to answer any question.

## Supervision powers (Cont'd)

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Authorized person may in writing require the person giving an answer under section 180 to verify within a reasonable period specified in the requirement the answer by statutory declaration, which may be taken by the authorized person.

## Supervision powers (Cont'd)

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Section 180 shall not be construed as requiring an AFI, not being the subject intermediary, associated entity or related corporation, to disclose any information or produce any record/document relating to the affairs of a customer unless the relevant authority is satisfied, and certifies in writing that it is satisfied that disclosure is necessary for the purpose of this section.

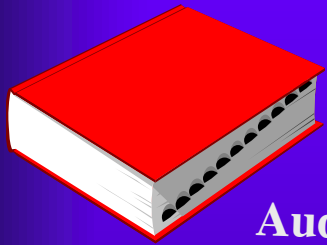
## Supervision powers (Cont'd)

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- ◆ Generally, before exercising any power on a corporation where the corporation is an AFI, its controller, has as its controller an AFI or has a controller that is also a controller of an AFI, authorized person shall consult the MA.
- ◆ Similarly, in the case of an insurer authorized under the Insurance Companies Ordinance, authorized person shall consult the Insurance Authority.



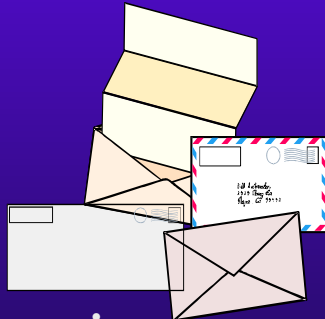
**Risk Rated  
Assessment**



**Auditors'  
Report**



**Overseas  
Regulators**



**Licensing  
Application**



**Inspection  
Results**



**Complaint  
Hotline**

# Assessment methodology

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- ◆ Management and Company Profile
- ◆ Financial Stability
- ◆ Compliance History
- ◆ Business Quality
- ◆ Market Intelligence

# Financial Data Analysis

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- ◆ Risk indicators
- ◆ Sensitivity analysis towards market changes

## Risk Indicators - Objectives

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- ◆ 51 risk indicators are currently in use
- ◆ Pointers to signs of
  - higher financial risk
  - potential misuse of clients' securities
- ◆ Enable risk-focused and efficient review of financial returns
- ◆ Risky firms are identified for monitoring / targeted for inspection

# Investigation



# Investigation powers

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- ◆ Power to compel:
  - documents
  - explanations of documents
  - interviews and
  - any other reasonable assistance

## Investigation powers (Cont'd)

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- ◆ For investigation of:
  - crimes under SFC administered laws
  - fraud or misconduct involving SFC regulated products
  - insider dealing
  - acts contrary to public interest

# Investigations

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SFO gives the SFC express power to investigate

- ◆ grounds for discipline against licensed corporations and registered institutions, their staff, officers and those involved in their management; and
- ◆ collective investment scheme and advertisements, invitations and documents relating to investment products.

## Discipline

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SFO allows for fines up to maximum of \$10m or 3 times profit or loss whichever higher

- ◆ Alternative or additional to other sanctions
- ◆ Fines paid into general revenue of HKSAR
- ◆ SFC must publish and adhere to fining guidelines

## Discipline

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SFO allows for partial suspension or revocation

- ◆ Minimises unintended harm to third parties
- ◆ Important given “single licence” proposal

## Settlements

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- ◆ SFO gives SFC formal settlement power
- ◆ Settlement must be in interest of investing public or public interest
- ◆ Settlements are usually publicized

## New safeguards

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- ◆ Fining guidelines
- ◆ Reprimands and fines appealable
- ◆ Consultation with HKMA on AFIs
- ◆ SFC expressly obliged to refer to codes of conduct and other guidance when disciplining for misconduct not in public interest
- ◆ Process Review Panel

# Powers of intervention & Proceedings



## **Powers of intervention**

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Section 204 - Restriction of business

Section 205 - Restriction on dealing with property

Section 206 - Maintenance of property

Section 207 - Imposition of prohibition/ requirement under s204, s205 or s206

Section 208 - Withdrawal, substitution or variation of prohibition/ requirement

## **Powers of intervention**

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Section 209 – General provisions

Section 210 – Cases of revocation or suspension of licensed corporation's licences

Section 211 – Application to Court of First Instance relating to non-compliance with prohibition/requirement

## Restriction of business

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- ◆ Relevant to licensed corporations
- ◆ May be prohibited from carrying on business, including entering into transactions, soliciting business, etc
- ◆ May be required to carry on business in a specified manner

# Restriction on dealing with property

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- ◆ May be prohibited from disposing of property or dealing with it in (or other than in) a specified manner **or** assisting, counselling or procuring another person to do so
- ◆ May be required to deal with property in a specified manner

# Maintenance of property

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- ◆ Licensed corporations can be required to maintain property in HK or in any specified place outside HK
- ◆ To ensure
  - Licensed corporations can meet its liabilities relating to the regulated activity
  - Property is maintained in a way that allows the licensed corporation to transfer or dispose of it



# Imposition of prohibition or requirement

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The SFC may only impose prohibitions or requirements if it must appear to the SFC:

- (a) property of the licensed corporation or its clients, may be dissipated, transferred or dealt with in a manner prejudicial to the interest of any of its clients or creditors;
- (b) failure to comply with the SFO, notices or requirements under any of the relevant provisions, conditions;

# Imposition of prohibition or requirement (Cont'd)

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- (c) Grounds for revoking or suspending licence where guilty of misconduct and in other circumstances, e.g. entering into voluntary arrangement with creditors; or
- (d) In public interest or interests of the investing public.

The prohibition or requirement may be withdrawn, substituted or varied, on application by the licensed corporation or of the SFC's own volition.

# General provisions

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- ◆ Must have statement of reasons
- ◆ Restriction notice must be published in Gazette and may be published elsewhere as SFC considers appropriate
- ◆ Statement of reasons may be included when published if the SFC thinks appropriate
- ◆ Must use best endeavours to inform exchange company and clearing house before imposing restriction notice, but if not possible must be done forthwith afterwards.

# Cases of revocation or suspension of licences

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- ◆ Makes clear that revocation or suspension of licence does not affect the validity of a restriction notice as long as it took effect prior to revocation or suspension.
- ◆ May still be varied or withdrawn after revocation or suspension.

# Application to the Court of First Instance for compliance order

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- ◆ Upon failure to comply with a restriction notice
- ◆ Court must be satisfied that there is no reasonable excuse for non-compliance before making compliance order
- ◆ Court may punish a person as if guilty of contempt of court if failure without reasonable excuse

## Other powers & proceedings

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- ◆ Section 212 - Winding-up orders & bankruptcy orders
- ◆ Section 213 - Injunctions & other orders

# Winding up orders & bankruptcy orders

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## ◆ Winding up

- Just and equitable grounds
- Any company (other than AFI)
- Must use best endeavours to inform exchange company and clearing house of proposed petition, but if not possible must be done forthwith afterwards

## ◆ Bankruptcy

- Licensed representatives

In both cases, SFC must be satisfied it is desirable in the public interest

# Grounds for application for injunctions and other orders

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Contraventions of –

- ◆ The relevant provisions
- ◆ Notices or requirements under the relevant provisions
- ◆ Any licence or registration
- ◆ Other condition imposed under the SFO

# Who can be the subject of an order?

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- ◆ Any person who contravenes a relevant provision, notice or condition
- ◆ Licensed corporations and banks
- ◆ any person who aids or abets, induces or is knowingly involved in, any such a contravention

## Way forward

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- ◆ Do you need a licence?
  - If yes,
    - start dialogue with Licensing
    - assess your compliance readiness and start to prepare

**NOW!!**

# Compliance readiness

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- ◆ Familiarity with statutory & non-statutory requirements
- ◆ Staff deployment
- ◆ System enhancement
- ◆ Internal control policies and procedures
- ◆ Capital restructuring

◆ Please direct

- all licensing questions to  
Connie Hui at 2842-7603; and
- all other questions to Lorraine Chan  
at 2842-7751.