

**Consultation Papers on
Competence and Continuous Professional Training**

Hong Kong
March 2000

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1. INTRODUCTION

This consultation document invites public comments on general guidance in assessing the competence of an applicant for registration and the introduction of continuous professional training requirement.

In its June 1999 consultation paper “Review of Licensing Regime”, the Commission proposed the setting out of competence standards for registrants and the establishment of a continuous training requirement as an on-going obligation for licensed persons. The Commission also proposed a requirement that licensed corporations must have a training policy to provide continuous training to their accredited representatives. These proposals were generally welcomed by the industry.

Against this background, the two Consultation Papers in this consultative document call for comments on the more detailed proposals on competence and training. Following consultation, the additional guidance on competence and training will be incorporated into the “**Fit and Proper Criteria**” – the Commission’s general guide to how it exercises its licensing powers.

This consultation document is available at the Commission’s website at <http://www.hksfc.org.hk>. Printed copies will be available from the Commission’s office. Written comments are welcome and should reach the Commission by 31 March 2000 either through e-mail to “licconsult@hksfc.org.hk” or mail to:

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2. CONSULTATION PAPER ON CRITERIA IN ASSESSING THE COMPETENCE OF LICENSEES

Purpose

1. This paper provides general guidance on the matters that the Commission will consider in assessing whether an applicant for a licence is fit and proper, in particular it considers the requirements of subsections 23(3)(b) and 23(3)(c) of the Securities and Futures Commission Ordinance (“SFCO”). Both corporate applicants and natural persons applying to become the registered directors¹ or representatives of a corporation must demonstrate that they are fit and proper to obtain the particular approval sought. Subsections 23(3)(b) and 23(3)(c) of the SFCO direct attention to, amongst other things, an applicant’s educational qualifications and his ability to perform the proposed activities efficiently. In this practice note, these requirements are referred to compendiously as the applicant’s competence. The content of the requirements will vary according to the nature of the application and the business or responsibility to be undertaken and this paper discusses these various matters.

Introduction

2. Under section 23 of the SFCO, the Commission is obliged to refuse registration unless the applicant satisfies the Commission that they are fit and proper to be registered. The fitness and properness of an applicant essentially rests on the following:
 - (a) financial status;

¹ Registered directors refer to directors or accredited persons who are directly responsible for the supervision and actively participate in the registrable business.

- (b) educational or other qualifications or experience having regard to the nature of the functions to be performed;
 - (c) ability to perform such functions efficiently, honestly and fairly; and
 - (d) reputation, character, financial integrity and reliability.
3. Section 65A of the Securities Ordinance states that an applicant for registration as a dealer under the said Ordinance shall not be regarded as having sufficient qualifications and experience in dealing in securities unless he has not less than three years experience in dealing in securities. There is currently no prescribed statutory requirement for representatives or advisers under the Securities Ordinance and commodity dealers, commodity trading advisers or representatives under the Commodities Trading Ordinance.
4. The Fit and Proper Criteria published by the Commission, which sets out the Commission's general expectation of what is necessary to satisfy the licensing requirement that an applicant is fit and proper, states, at clause 3.3(g), that individuals applying for registration as dealers or advisers will generally not be considered fit and proper unless they have at least five years relevant experience². However, applicants that have attained educational qualifications appropriate to the duties to be performed may be able to establish that shorter appropriate experience justifies registration. Some examples of educational qualifications that will be considered appropriate are:
- (a) an appropriate post-secondary qualification – for example in Law, Business, Accounting or Economics; and

² The Fit and Proper Criteria themselves note the difference between clause 3.3(g) and section 65A of the Securities Ordinance. The explanation given is as follows: “The usual experience requirement sets out in these guidelines is somewhat higher than the statutory minimum. This is because these guidelines serve a different purpose from the legislation: The legislative provision sets an absolute floor level of prerequisite experience while these guidelines set out the criteria that the SFC will usually adopt in assessing applications ...”

- (b) successful completion of an appropriate recognised industry- based course – such as those run by the Securities Association and The International Stock Exchange of the United Kingdom and the Republic of Ireland Limited; the Securities Brokers Course conducted by the Stock Exchange of Hong Kong Limited; the examinations conducted under the approval of the Securities and Exchange Commission and the Commodity Futures Trading Commission in the United States; the Diploma Course provided by the Securities Institute of Australia; the examinations conducted by the Canadian Institute of Securities; the Diploma of the Association of International Bond Dealers; the Japanese Securities Dealers Association Representative of Public Securities Course; the Securities Brokers Examination conducted by the Stock Exchange of Hong Kong Limited; or the HKSI Foundation Programme Examination and HKSI Financial Market Principal Programme Examination conducted by the Hong Kong Securities Institute.
5. For representatives, the Fit and Proper Criteria sets out the Commission’s general expectation that they have to complete form 5 or its equivalent.
6. This paper does not have the force of law and will be an elaboration on the Fit and Proper Criteria.

Importance of Competence

7. The Commission has amongst its objectives, the protection of investors and the reduction of systemic risk. Both objectives may be promoted through an insistence upon the competence of applicants and registrants.

Entry Competence Requirement

8. This paper should be read together with the Fit and Proper Criteria for a full understanding of what the Commission expects of an applicant for a licence or registration.
9. An applicant may be able to satisfy the Commission that he should be registered even when he cannot satisfy the expectations set out in this paper. The most important consideration remains whether, as a subjective matter, the applicant has demonstrated that he is fit and proper to be licensed. The difficulty of making that subjective judgement means that, as a practical matter, the Commission has identified certain objective criteria that, in the absence of indications to the contrary, will give it comfort in arriving at its subjective licensing decision.

The Corporate Applicant

10. Where an applicant for a licence is a corporation, competence generally can be considered by reference to the corporate applicant's organizational structure and the combined competence of its personnel.
11. Proper infrastructure and good control systems, coupled with qualified personnel, give a corporation the ability to efficiently and effectively manage the risks it will encounter in carrying on its business. This is a matter to be

assessed against the particular business plan of a new applicant and the actual operations of a registrant. The requirement is an ongoing one. The Commission must therefore be provided with a business plan by a new applicant and, thereafter, should be informed of material changes in business and structure.

The Natural Person

12. Persons applying to become the registered directors or representatives of a corporate applicant must show that they are competent by reason of their education and experience to provide professional and high quality service to the investors and other clients. In appropriate cases, they must also demonstrate necessary managerial competence.
13. The Commission believes that applicants must possess a knowledge of the laws and regulations and the associated codes governing their intended industry sector. In addition, they should be aware of the ethical standards required of a licensed person. This is essential in maintaining investor confidence in the profession and the integrity of the markets in Hong Kong. Finally, they should possess a knowledge and understanding of the products that they deal in or advise upon and the markets in which they provide those services.

Test of Competence For Corporation

14. In assessing the competence of a corporate applicant, the Commission will consider the matters set out below under the headings Organizational Structure and Personnel. Clearly, the significance of particular matters will vary according to the size and nature of the corporation's proposed or actual operations. The failure to satisfy one of the general requirements set out below will not necessarily lead the Commission to conclude that the corporation is not

competent but it will call for some explanation. In particular, the Commission will want to be satisfied in the particular case, either that the general requirement is unnecessary for an intermediary of that size or one conducting that type of business or that the objective to be served by a particular requirement is addressed in some other way.

15. The Commission will administer the criteria flexibly and will take into account the size and the nature of the applicant's proposed business.
16. For corporations in which the scale of business operation and the staff numbers are relatively small, it is appreciated that sometimes in practice segregation of duties may not be possible. Under such circumstances, the Commission may consider alternative arrangement if the corporation can demonstrate a competence to manage risk exposures and to exercise effective control over operations. Clear written operational and counter checking procedures must be available.

I. Organizational Structure:

(a) Corporate Governance

- the presence of an organization structure with clear lines of authority
- a Board of Directors and senior management, including Committees of the Board, composed of individuals with an appropriate range of skills and experience to understand and run the corporation's proposed activities
- a Board of Directors and senior management, including Committees of the Board, organized in a way that enables it to address and control the activities of the corporation

- (b) Business Profile and Risk Profile
 - information on the proposed lines of business
 - information on business strategy, marketing emphasis and competitive challenges
 - extent of system automation
 - analysis of risks inherent to the key lines of business such as market risk, credit risk, liquidity risk, operational risk

- (c) Risk Management and Control Strategy
 - the presence of a clear risk management strategy with reference to the proposed lines of business
 - the setting of proper exposure limits for each key line of business
 - the anticipated risks being supported by the available capital (typically this will be demonstrated by a projected Financial Resources Rules calculation)
 - the timing of review of established policies (e.g. subject to regular review or just with respect to changes in business and markets...etc)

- (d) Risk Management Policy and Procedures
 - appointment of an independent risk manager who is appropriately experienced to oversee and monitor the risk exposure of the corporation
 - the presence of clear reporting lines for the independent risk manager
 - the way that risks exposure limits are set and communicated to the trading staff
 - the way that risks are monitored
 - the way that risks are measured
 - the procedures to deal with variation of risk limits

- processes to ensure that the corporation regularly carries out stress testing using appropriate measures, such as “value at risk”
- (e) Reporting and Control Functions
- the presence of reliable reporting systems ensuring that robust information is produced for risk management purpose
 - the presence of control procedures to ensure data integrity and that data flowing into the risk management system should be consistent with trade and financial information
- (f) Internal and External Audit Functions
- internal and external audit personnel have appropriate qualifications and working experience to understand the corporate activities and risk profile
 - internal audit group independent of core business functions and reporting directly to an independent and high level of authority
 - internal audit group to perform annual risk assessment and ascribe various levels of risk to an appropriate audit cycle
 - a requirement that audit findings that are not resolved within established time frames being reported to senior management
- (g) Internal Control System
- adequate internal control systems set up in accordance with the relevant codes and guidelines
 - arrangements in place to ensure proper audit trails are maintained
 - the presence of procedures to deal with non-compliance
 - requirements for the proper documentation of all operational and control procedures

- (h) Chinese Walls
 - policies and procedures on “Chinese Wall” including “Cross Wall” to address conflicts of interests issues arising from carrying on more than one type of regulated activities concurrently (e.g. corporate finance and asset management activities) under a single licence.

- (i) Information Technology Support
 - appointment of an independent information technology manager who is appropriately experienced to maintain the system integrity of the corporation

 - for corporations providing services over the internet, suitably qualified staff assigned to handle internet communication and transactions

 - sufficient capital resources to meet necessary technological maintenance and improvements

II. Personnel :

- (a) Qualified Staff
 - the presence of policies and procedures to ensure that suitably qualified staff are in post including, but not limited to, all registered employees, risk manager, compliance officer, head of settlement and accounting officer

 - all supervisory staff for both front and back office should have not less than 3 years relevant experience plus academic qualifications

(b) Training Policies

(i) For new recruits

- arrangements to ensure that operational and control procedures are communicated to new employees
- arrangements to ensure relevant operational and control manual are distributed to staff

(ii) For existing staff

- arrangements to ensure that changes to operational and control procedures are communicated to existing staff
- the presence of appropriate staff on-going training policies and procedures (For the Commission's requirements in this aspect, please refer to the paper on continuous professional training)

Test of Competence For Registered Director

17. In assessing the competence of a registered director, the Commission will ensure that the registered director possesses an appropriate range of skills and experience to understand the corporation's proposed activities. This can normally be demonstrated by fulfilling one of the following options:

(i) Option 1:

Under option 1, the applicant must have:

- an appropriate post secondary qualification in financial discipline (such as economics, finance, accounting) or equivalent;

- obtained a pass in one of the prescribed short industry qualification courses³ in order to gain industry specific knowledge (prescribed industry courses are set out in annex 1);
- the equivalent of 3 years relevant industry experience over the immediate past 6 years; and
- not less than 2 years proven management skill and experience.

(ii) Option 2:

Under option 2, the applicant must have:

- obtained passes or above in English, Chinese and Mathematics in HKCEE or equivalent;
- obtained a pass in one of the prescribed short industry qualification courses³ in order to gain industry specific knowledge (prescribed industry courses are set out in annex 1);
- the equivalent of 5 years relevant industry experience over the immediate past 8 years; and
- not less than 2 years proven management skill and experience.

³ For applicants who have left the industry for an extended period of time (say three years) and who apply for registration to perform functions substantially similar to those for which they were registered, the Commission, will flexibly consider this requirement for meeting the prescribed short industry qualification courses.

(iii) Option 3

Under this option, the applicant must have:

- the equivalent of 8 years relevant industry experience over the immediate past 11 years;
- completed one of the prescribed short industry qualification courses³ in order to gain industry specific knowledge (prescribed industry courses are set out in annex 1); and
- not less than 2 years proven management skill and experience.

Test of Competence for Representative

18. In assessing the competence of a person applying to be a representative, the Commission will wish to ensure that the applicant possesses an appropriate range of skills and experience to carry out his functions in a professional manner. This can normally be demonstrated by fulfilling one of the following options:

(i) Option 1

- obtained passes or above in English or Chinese, and Mathematics in HKCEE or equivalent; and
- obtained a pass in one of the prescribed short industry qualification courses³ in order to gain industry specific knowledge (prescribed industry courses are set out in annex 2).

(ii) Option 2

- in a position of responsibility in the relevant industry for a period of not less than 2 years over the immediate 5 years; and
- obtained a pass in one of the prescribed short industry qualification courses³ in order to gain industry specific knowledge (prescribed industry courses are set out in annex 2).

(iii) Option 3

- possess the equivalent of 3 years relevant industry experience over the immediate past 6 years; and
- completed one of the prescribed short industry qualification courses³ in order to gain industry specific knowledge (prescribed industry courses are set out in annex 2).

Recognized Short Industry Qualification or Courses for Registered Director

The following list of short industry qualification or courses proposed to be recognized by the Securities and Futures Commission for the purposes of gaining industry specific knowledge for entry as registered director:

1. HKSI Financial Market Principal Examination
2. US General Securities Principal – Series 24
3. FSA Registered Persons Examination
4. SIA Graduate Diploma in Applied Finance And Investment

It should be noted that the above courses should be completed not less than 3 years prior to the date of application for approval as registered director.

The completion of the above courses shall only meet the prescribed minimum. In addition, the Commission expects all registered directors to have attained the prescribed short industry qualification specific to the activities to be performed which are applicable to representative.

The above list of recognized courses will be updated from time to time by the Commission.

Recognized Short Industry Qualification or Courses for Representative

The following list of short industry qualification or courses proposed to be prescribed by the Securities and Futures Commission for the purposes of gaining industry specific knowledge for entry as representative:

1. HKSI Foundation Programme Examination
2. US General Securities Representatives – Series 7
3. US Futures Representative – Series 3
4. FSA General Representative Examination
5. SIA Certificate in Financial Markets

It should be noted that the above courses should be completed not less than 3 years prior to the date of application for approval as representative.

In assessing whether the applicant possesses sufficient industry specific knowledge, the Commission shall have regard to the activities to be performed by the applicant.

The above list of recognized courses will be updated from time to time by the Commission.

3. CONSULTATION PAPER ON CONTINUOUS PROFESSIONAL TRAINING

This paper provides general guidance to be set out in the Fit and Proper Criteria on the Commission's Continuous Professional Training (CPT) requirements. Licensed persons should undertake CPT to ensure that they remain fit and proper to act as financial intermediaries. Employers should ensure that their staff can and do undertake CPT as appropriate.

Introduction

1. Registrants are required to be and to remain fit and proper. A registrant must continue to be fit and proper, amongst other things, by reason of:
 - (i) his educational or other qualifications or experience having regard to the nature of the functions which the person performs (cp section 23(3)(b) of SFCO);
 - (ii) his ability to perform such functions efficiently, honestly and fairly (cp section 23(3)(c) of SFCO).
2. The securities, futures and leveraged foreign exchange industries are characterised by rapid change and innovative financial products. In a changing technical and professional environment, registrants should continuously update their knowledge and skills through CPT in order to maintain their professional competence and to remain fit and proper.
3. The Commission has amongst its statutory objectives, the protection of investors and the reduction of systemic risk. Both objectives may be promoted

through an insistence upon the continued technical competence of licencees and registrants as assisted by CPT.

4. A corporate registrant is also expected to ensure that through the training made available to and undertaken by its staff, those staff and the corporate registrant itself remain fit and proper.
5. This paper does not have the force of law and its contents will be incorporated into the Fit and Proper Criteria.

Objectives of Continuous Professional Training

6. CPT is the systematic maintenance, improvement and broadening of knowledge and skill to enable registrants to successfully carry out their duties competently and professionally. The objectives of CPT programme are:
 - (a) to maintain and enhance the technical knowledge and professional expertise of registrants;
 - (b) to provide assurance to investors at large that the registrants they rely upon have the technical knowledge, professional skills and ethical standard required to perform their functions efficiently, effectively and fairly; and
 - (c) to maintain and enhance Hong Kong's international reputation for high standards amongst registrants.
7. The Commission believes that the objectives of CPT will not be achieved purely through work experience or "on the job" training. The Commission believes that it will generally be necessary for a registrant to undertake CPT if they are to remain fit and proper.

8. The requirements for CPT will vary according to the size and nature of the business and the nature of the responsibilities undertaken by a registrant. Rather than mandating particular programs, this paper describes the general objectives and attributes of the CPT program.

The Continuous Professional Training Programme

9. The obligation to conduct and maintain CPT will be imposed upon all registrants, that is both corporations as well as their registered directors and representatives. Corporate registrants are responsible for ensuring that their registered directors and representatives accredited to the corporations are suitably qualified to carry out their duties effectively and that they remain so. As such, the onus is on the corporate registrant to provide or facilitate the provision to their accredited directors and representatives the continuous training they need in order to maintain their professional competence and to ensure that they remain fit and proper.

Obligation of the Corporate Registrants

10. Corporate registrants are required to design and implement a continuous education programme for their registered directors and representatives to enhance their industry knowledge, skills and professionalism. As a minimum, the corporate registrant should annually evaluate and prioritise its training needs and develop a training plan. The plan must take into consideration the corporation's size, organisation structure, risk management system, scope of business activities as well as prevailing regulatory framework and development. A training programme can be provided internally or make use of appropriate available external sources.

11. The primary responsibility lays with senior management of a corporate registrant to ensure that an adequate CPT program is in place and that staff in fact undertake the CPT.

CPT Requirement on the Individual Registrants

12. An individual must remain fit and proper at all times. The fitness and properness of an individual is often a difficult matter to assess, depending as it does upon the particular responsibilities of that individual. The difficulty of making that subjective judgement means that, as a practical matter, the Commission has set out certain requirements that, objectively, make it more likely that a registrant will remain fit and proper. One such requirement is the requirement that an individual undertakes CPT. The Commission recognises that effective CPT is best assessed by reference to the individual's work and that it must be of significant intellectual or practical content. It is acknowledged that the CPT requirement applicable to a registered director on the one hand and representatives on the other hand should be expected to differ in terms of scope of subject matter, detail and duration of CPT hours. Attending courses, workshops, lectures and seminars organised by recognised institutions, long distance learning, self-study, industry research, publication of papers and delivery of speeches are considered to be an indication of CPT achievement.
13. Registered directors refer to those directors or accredited personnel who actively participate in or are directly responsible for the supervision of the corporate's registrable business. As they play a crucial role in ensuring effective corporate governance and control, they should normally undertake not less than 20 CPT hours within two calendar years, with a minimum of 5 CPT hours per year. Topics of interests will, amongst others, include updates on:

- (a) applicable compliance, legislative and regulatory standards;
 - (b) business conduct and ethical standard;
 - (c) new financial products in the industry and associated risk system;
 - (d) trade practices;
 - (e) risk management and control strategy;
 - (f) general management and supervisory skills;
 - (g) computer knowledge;
 - (h) macro and micro economic analysis; and
 - (i) financial reporting and quantitative analysis.
14. Representatives are required to remain fit and proper to perform the duties of a representative at a professional level. The Commission believes that they should normally undertake not less than 10 CPT hours within two calendar years, with a minimum of 5 CPT hours per year. Topics of interests will, amongst others, include updates on:
- (a) applicable compliance, legislative and regulatory standards;
 - (b) business conduct and ethical standard;
 - (c) new financial products in the industry and associated risk system;
 - (d) business communication skills and trade practices;
 - (e) computer knowledge;
 - (f) basic accounting theories; and
 - (g) fundamental economic analysis.

Monitoring of CPT Compliance

15. Corporate registrants should have in place a continuous education programme and be actively involved in arranging, organising or sponsoring training to promote and improve the professional competence and continued fit and proper standing of its registered personnel. In addition, a corporate registrant will be required to file a declaration in the annual return stating the continuous

professional training assessment and implementation undertaken during the year. It also has the responsibility to ensure and confirm annually that all its registered directors and representatives have undertaken the requisite CPT hours.

16. Similarly, all registered directors and representatives are required to retain appropriate records of all CPT activities completed in a calendar year. Documentary evidence sufficient to support their attendance or completion of the CPT activities should be kept by the individual for a minimum of 3 years, and these should be produced when required by the Commission. In addition, individuals will be required to declare in their annual returns that they have attained their CPT hours.
17. An incorrect or false declaration made to the Commission by registrants (corporate or individual) may lead to revocation or suspension of the licence following disciplinary inquiry.

Consequence of Non-Compliance

18. Registrants (corporations or individuals) are reminded that the onus is on them to maintain such CPT record and failure to produce the CPT records required will raise questions about the fit and properness of the registrant and may lead to disciplinary action by the Commission.
19. Whether CPT requirement has been complied with during the year will be, amongst others, one of the aspects that will be scrutinised by Intermediaries Supervision Department of the Commission in its inspection. Corporate registrants who fail to have in place appropriate CPT programme or who fail to keep appropriate records in respect of its or its registered directors and representatives CPT compliance will cast doubt on its fit and properness to remain registered. Similarly individuals who fail to comply with the minimum

CPT requirements will raise doubt on their fit and properness. These failures may lead to disciplinary action by the Commission.

Role of Securities Institute and other Recognised Organisation

20. The Commission will liaise with the Securities Institute, tertiary educational institutions, associations in Hong Kong or overseas on CPT development programme which may provide courses, lectures, seminars or other programmes of instruction to attain the requisite CPT hours to remain fit and proper.
21. The Commission will from time to time publish a list of approved courses that registrant may wish to undertake to meet the CPT requirement.

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March 1, 2000