

Expanding horizons

A new continent has been added to Hong Kong's fund management universe with a mutual recognition of fund managers deal with Australia

Hong Kong and Australia have reached a consensus on the mutual recognition of fund managers. Fund managers licensed by the Australian Securities Investment Commission (ASIC) would be able to manage investment schemes authorised by the SFC. This is a significant and encouraging step forward from the recent recognition by ASIC of standard bonds and equities funds that are established in Hong Kong and authorised by the SFC.

At present, the SFC's Code on Unit Trusts and Mutual Funds requires that the investment management operations of an authorised fund be based in a jurisdiction with an acceptable inspection regime (AIR). This is to ensure that the investment management activities of the fund is regulated and inspected by an overseas authority in a manner generally consistent with the SFC's own regulatory standards. The SFC can also get

information from the overseas authority for the purpose of cross-border supervision of the fund management company.

Overseas jurisdictions accepted by the SFC as AIRs include the United States and European countries acknowledged as major financial centres. Australia will be the first country in the Asia Pacific region to be added to this list.

The mutual recognition of fund managers benefits investors, local fund managers, and the Hong Kong fund market as a whole.

Investors will benefit from having a greater choice of retail funds to choose from. The introduction of innovative new funds managed by experienced Australian-based fund managers will certainly be a welcome addition to our fund market.

Local fund managers will have the opportunity to tap into the Australian fund market in a more cost-efficient manner. As mentioned earlier, ASIC already recognises standard bonds and equities funds that are established in Hong Kong and authorised by the SFC. Hence, local fund managers will enjoy regulatory compliance costs savings when they market their funds in Australia, as these funds are already deemed to have met most of ASIC's key requirements.

With the pooling and exchange of Hong Kong and Australian fund expertise leading to further product innovation, Hong Kong will be able to further develop as a major regional fund management centre.

Hong Kong already has one of the world's most open fund management industries. In the past 10 years, the local fund industry has developed in leaps and bounds. The number of authorised unit trusts and mutual funds registered with the SFC has grown from 920 in 1992, to 1,890 by the end of March 2002, with a net asset value of US\$285 billion.

The SFC is now working towards concluding the co-operation and mutual recognition agreement with ASIC in the third quarter of 2002.

SFO updates

SFO on BLIS

The SFC has created on its website (under the section of Securities and Futures Ordinance (SFO)) a new link to the full text of the SFO in the Bilingual Laws Information System (BLIS) operated by the Department of Justice. The public can easily access any specific provision

of the SFO with the BLIS's organised structure and its user-friendly "search" function.

Consultations and Conclusions

Over the last few weeks, the consultation exercises continued for various pieces of sub-legislation under the SFO. A number of Consultation Conclusions were also published. All the consultation and conclusions papers are available on the SFC website under the SFO section.

Consultation Papers on the following have been issued since 15 May 2002:	Issue Date	Closing Date
Securities and Futures (Leveraged Foreign Exchange Trading - Exemption) Rules	5 June 2002	26 June 2002
Securities and Futures (Short Selling Exemption and Stock Lending) Rules	24 May 2002	21 June 2002
Securities and Futures (Disclosure of Interests - Exclusions) Regulation	16 May 2002	8 June 2002
Consultation Conclusions on the following have been issued since 15 May 2002:	Issue Date	
Securities and Futures (Contract Notes, Statements of Accounts and Receipts) Rules	6 June 2002	
i) Securities and Futures (Levy) Order	5 June 2002	
ii) Securities and Futures (Levy) Rules		
Securities and Futures (Registration of Commission Disciplinary Orders) Rules	5 June 2002	
i) Securities and Futures (Investor Compensation - Levy) Rules	5 June 2002	
ii) Securities and Futures (Investor Compensation - Compensation Limits) Rules		
iii) Securities and Futures (Transfer of Functions - Investor Compensation Company) Order		
iv) Securities and Futures (Investor Compensation - Claims) Rules		
Securities and Futures (Professional Investor) Rules	4 June 2002	
Securities and Futures (Gold Purchase) Notice	3 June 2002	
Securities and Futures (Associated Entities) Rules	30 May 2002	

SHORTS

- Regularly checking the warning list of unlicensed overseas companies on the SFC website may well save you a lot of money. This was certainly the case for a UK investor Mr A (real name withheld) who avoided falling victim to an investment scam. Mr A had been under pressure from a Scott Mills of First Chartered Capital who contacted Mr A by phone and fax for two weeks. Mr A was about to send Mills £5,000 to invest in his "once in a life time" offer. Luckily Mr A visited the SFC website, read the article on "Boiler Room" frauds and checked the warning list, on which First Chartered Capital appeared. He immediately withheld the money. He sent an email to the SFC to say "thank you". He said that he was glad that the SFC highlighted these companies before he got ripped off. The warning list saved Mr A his hard earned money. It could also save yours!
- The SFC has announced amendments to the existing Financial Resources Rules. Firms providing securities margin financing will be required to: (a) apply a 80% "illiquid collateral discount" to the value of stock collateral that are difficult to liquidate; and (b) where a firm's total borrowings which are secured by repledging margin clients' securities exceed 65% of its total margin loan, include the excess amount in the firm's ranking liabilities. The amended Rules will become effective on 1 October 2002.
- The SFC's Hedge Funds Guidelines became effective on 17 May 2002. To facilitate market practitioners' applications for hedge fund authorisation, the SFC has prepared an application checklist. The checklist can be downloaded from the SFC website under Part C of Volume 2 of the Regulatory Handbook in the "Bills, Legislation & Codes" section.

ENFORCEMENT

Unregistered dealing in cyberspace

It is the SFC's job to oversee all securities firms who target Hong Kong investors - even in cyberspace

The SFC has noted that some overseas securities firms, which are not licensed in Hong Kong, offer local investors the opportunity, via hyperlinks on their websites, to open accounts and trade in stocks overseas.

The SFC welcomes the increase in investment opportunities for local investors, and also supports technological advances that make securities dealings more efficient and less costly. The Commission has a duty, however, to protect local investors by overseeing the activities of all securities firms who target Hong Kong investors.

To ensure the standards of financial intermediaries and to afford investors an effective protection, registration with the SFC is a must for companies engaging in securities dealing in Hong Kong unless they are exempted. Whether a company is an online broker or a traditional broker makes no difference.

The case of GlobaLinkAsia.com Ltd (GLA), which was recently prosecuted for unregistered dealing and the issuance of unauthorised advertisements, demonstrates the SFC's

commitment to impartial enforcement and investor protection.

Between May 2000 and May 2001, GLA, a subsidiary of a licensed securities dealer in the US, operated a local website which was hyperlinked to the online trading platform of its parent company in the US. Investors could open accounts and trade stocks in the US via the website. GLA was not registered and it already breached the Securities Ordinance.

The company also kept and distributed promotional documents and account opening forms at its Hong Kong office, and referred potential clients to its website for details and to open accounts. These documents and the materials on the website contained an invitation to the public to deal in securities, which had not been authorised by the SFC. Hence, GLA was also in breach of the Protection of Investors Ordinance.

The SFC successfully prosecuted GLA for these offences. The company pleaded guilty to six summonses before Mr P C White at Western Magistracy on 5 June 2002. It was fined a total of \$280,000 and ordered to pay costs of \$14,178 to the SFC.

In considering the penalty, Mr White commented that the offences were very serious. The potential damage of unregistered companies operating from an overseas mother company to solicit funds from Hong Kong investors, who were left with no possibility of recovery in the case of default, was enormous. The penalty imposed was intended to deter not only the defendant company, but also other parties who intended to act similarly.

The SFC would like to remind market participants that the mere presence of a hyperlink to an overseas trading platform does not normally trigger a licensing requirement. The presence of any inducement, or invitation, to visit the related sites through the links concerned may, however, mean a licence is required. In general, investors should make sure that they are dealing with qualified professionals who have registered with the SFC.

For more details, market practitioners can refer to the "Circular on Provision of Financial Information on the Internet - Licensing Requirements" issued by the SFC on 30 June 2000. The Circular is available on the SFC website under the "Intermediaries, Licensing & Investment Products - Update for Intermediaries - Others" section.

FinNet - the financial services network



Keeping the financial community informed and connected

Information, it is often blithely asserted, is the lifeblood of markets. What is sometimes overlooked, however, is that just as important as information is communication.

FinNet - the secure online network connecting financial market participants in Hong Kong - is much more than an information channel between the SFC and its registrants. It is emerging as a single network for communications and transactions between Hong Kong's regulators, banks, brokers, investment advisors, and information providers.

Since its launch in July 2001, this secure, open, scalable and high performance network has expanded with cross-links with other regulators and market players.

The Hong Kong Monetary Authority (HKMA) and Hong Kong Exchanges and Clearing Limited (HKEx), for example, now offer their services via FinNet. These include access to the HKMA's announcements and HKEx's CCASS (the Central Clearing and Settlement System). An e-IPO mechanism is also in place to allow the backend processing of share subscriptions between brokers and share registrars in an initial public offering.

Keep in touch

All SFC registrants are automatically entitled to a FinNet membership, which includes a FinNet e-mail account. Since 1 May 2002, the SFC has been sending out circulars to registrants through FinNet e-mail accounts, replacing the traditional paper-based system. This allows more convenient, secure and timely communication. Besides the circulars, other SFC documents and publications are also delivered via the FinNet e-mail network, and FinNet has become a one-stop-shop for an expanding range of e-SFC services, including:

- e-FRRR - registrants can submit their Financial Resources Rules Returns to the SFC electronically;
- e-Circulars - besides being sent by e-mail, the circulars are also posted on the FinNet website;
- e-Consultation - consultation papers issued by the SFC are made available on FinNet; and
- e-Newsletters & e-Publications - SFC newsletters and other publications are

also posted on FinNet for viewing and downloading.

Other new features to be introduced to the e-SFC shortly include an "e-Licensing" system (for electronic submission of licence applications), and an "e-Survey" system (that enables the conducting of online surveys). The "search" function of FinNet is also a valuable feature for registrants, enabling user-friendly access to the data on FinNet.

Watch this space

The SFC expects that new services and applications, including those provided by third-parties, will be gradually launched on FinNet, ultimately realising FinNet's vision of making Hong Kong one of the first international financial centres to achieve straight-through processing and real-time delivery versus payment for financial transactions on a single secure network interconnecting all financial institutions.

SFC Registrants can visit the FinNet website at www.finnet-hk.net, and should refer to the SFC letter sent in January 2002 for FinNet login IDs and e-mail addresses. Members of the public interested to know more about this private network can visit FinNet's public website at www.aboutfinnet-hk.net.

A fine balance

The SFC's simplified and rationalised licensing regime is more user-friendly for intermediaries and gives investors better protection

Simplifying the procedures required of financial intermediaries applying for an SFC licence does not necessarily mean lowering the standards required of persons applying to join the industry. The new licensing regime provided by the Securities and Futures Ordinance (SFO), for example, reduces compliance costs for intermediaries without compromising investor protection.

This has largely been achieved through a rationalisation of the existing licensing regime (outlined in the Securities Ordinance, Commodities Trading Ordinance, and the Leveraged Foreign Exchange Trading Ordinance), which requires practitioners to apply for as many as 12 different kinds of licences depending on what kind of activity they are involved in.

The single licence

All these licences will disappear when the new Ordinance becomes operational. The regulated activities will be subsumed into nine types:

- 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

Each intermediary will only need one licence to carry out more than one type of regulated activities, and only an additional endorsement (and not a new licence) is required for carrying out an additional regulated activity. The savings in capital and compliance resources will be tremendous.

Other efficiency gains

Another major efficiency gain has been the introduction of the 'responsible officer' concept. While the current system licenses dealing

directors and advisory directors in their own right, under the SFO they will be licensed as representatives and approved as responsible officers.

The practical advantage (apart from a more appropriately named licence category) is that the directors will be able to transfer the accreditations of their licences to another principal should they happen to change employment. (Under the current system, their licences will lapse upon their leaving the accredited firm.) An added flexibility is that, under the SFO, all representatives will have six months (four more than the existing system) to find a new employer before their licences expire.

Representatives may also look forward to receiving their licences within a week after submitting an application. These come in the form of a provisional licence. The intention is that a provisional licence will be issued upon a "no adverse information basis" and the applicant satisfying the competence requirements but before the completion of external vetting procedures by the SFC.

The fast track approval process will be extended, in the form of temporary licences, to overseas regulated intermediaries or representatives who wish to come over to Hong Kong to conduct business on a short-term basis. Although these are limited to types 1, 2, 4, 5 & 6 of the above regulated activities, and the approved period of each temporary licence cannot exceed three months, they are exempted from certain licensing requirements.

All existing licensees will be able to board a two-year transitional train, during which they will be deemed to have been licensed under the new regime. Dealing and advisory directors will carry on as responsible officers. The current exempt dealer and exempt investment adviser statuses (which mainly apply to authorised institutions) will give way to a registration system. Authorised institutions engaging in regulated activities will need to register with the SFC, and be subject to a similar regulatory regime.

As an additional investor protection measure, sole proprietors and partnerships will have to give way to corporations. This means existing sole proprietor and partnership firms must corporatise their

businesses before the end of the two-year transition.

Both intermediaries and investors benefit

The new licensing regime is more competitive, both in terms of compliance costs to the industry and in providing better protection to the investing public.

For intermediaries, a 3% across-the-board reduction in fees is planned. For example, the annual and application fees for a representative will be reduced to \$1,790 (from the existing \$1,850). As a further incentive, existing licensees seeking to convert their licence under the new regime in the first year will enjoy a further 5% early bird discount.

For investors, the new public register will contain a wider array of information on the status of licensees. Additions to the register are the conditions attached to each licence, a five-year disciplinary record of every licensee, and each firm's complaint channels.

"The implementation of the new regime will be a very exciting event for the industry," says the SFC's Director of Licensing, Lucinda Wong. "Licensing staff are storming ahead with preparations for the change-over, which entails rebuilding a new computer system, redesigning new application forms, carrying out public consultations on pertinent issues, rewriting licensing publications, and conducting internal and external training sessions, etc."

She has this advice for intermediaries: "To really reap the benefits of the efficiency window made available by the new licensing regime, intermediaries should reflect on their own business models as soon as possible and take steps to streamline and consolidate fragmented regulated activities under a single legal vehicle."

Her words to investors are: "The SFC's gatekeeping role in ensuring that only fit and proper persons are allowed to join the industry remains unchanged. Yet, there will be greater transparency under the new regime and investors can access the information from the public register maintained by the Commission."

A full version of an overview of the new licensing regime under the SFO is available on the SFC's website at www.hksec.org.hk. A set of Transitional Guidelines will further be issued shortly.

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