

Fit and Proper Criteria

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1. INTRODUCTION

1.1 In most financial markets throughout the world, intermediaries providing securities, futures and foreign exchange services are required to be authorised by a regulatory authority. This requirement arises from the need for market participants generally, and investors in particular, to have confidence that the people and organisations with whom they deal are efficient, honest and financially sound, and will treat them fairly.

1.2 Securities dealers, investment advisers as well as their representatives and commodity dealers, commodity trading advisers as well as their representatives in Hong Kong have been required to be licensed since 1974 and 1977 respectively. From 1994, leveraged foreign exchange traders and their representatives and from 2000, securities margin financiers and their representatives are also required to be licensed.

1.3 The Securities and Futures Commission Ordinance (“the SFC Ordinance”) enacted in 1989 substantially recasted and strengthened the requirements for licence under both the Securities Ordinance (“SO”) and the Commodities Trading Ordinance (“CTO”). In essence, applicants applying for licence under the SO or the CTO must satisfy the Commission that they are fit and proper persons before they will be licensed. The same spirit has been incorporated into the Leveraged Foreign Exchange Trading Ordinance (“LFETO”).

1.8

1.4 Section 23 of the SFC Ordinance, sections 121G and 121H of the SO and section 9 of the LFETO list a number of matters that the Securities and Futures Commission (“the SFC”) shall take into account in considering whether a person is fit and proper to be licensed, viz.,

- (a) financial status;
- (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.

1.5 The above sections empower the SFC, in considering the fitness and properness of a corporate applicant, to look through to the fitness and properness of the substantial shareholders, directors and officers of the company and of other companies in the same group.

1.6 The SFC is obliged to refuse an application if the applicant does not satisfy it that he is a fit and proper person to be so licensed. Thus, it places the onus on applicants to make out a case that they are fit and proper to be licensed to deal in securities, securities margin financing, futures contracts, or leveraged foreign exchange, to provide advice on securities, futures contracts, or to act as representatives.

1.7 The initial Fit and Proper Criteria described in Chapter 3 applies to all applicants for licence but additional requirements particular to leveraged foreign exchange trader, securities margin financier and their representatives are spelt out in Chapter 4.

1.8 In summary, the fitness and properness test applies to all applicants who wish to be licensed under the SO, the CTO or the LFETO. Moreover, the burden is on the applicants to prove that they are fit and proper persons to be licensed by the SFC.

2. FIT AND PROPER TEST

2.1 Although the requirement to be “fit and proper” is the overall “umbrella” test for licence, applicants must also satisfy the SFC that they meet the application requirements under the SO, the CTO, or the LFETO.

2.2 Particular requirements under each Ordinance ultimately impact on whether the applicant is a fit and proper person to be licensed. The criteria set out in Chapters 3 and 4 are, therefore, based on the existing licensing requirements in the SO, the CTO, or the LFETO, as the case may be and reflect the additional licensing requirements set out in section 23 of the SFC Ordinance.

3. INITIAL FIT AND PROPER CRITERIA

3.1 The following paragraphs (3.3 to 3.5) set out matters that are likely to give rise to concerns about the fitness and properness of applicants for licence. However, if an applicant fails to comply with all individual elements, the SFC may nonetheless be satisfied that the applicant is fit and proper. The SFC will look to the substance of the requirements and the materiality of any failure to meet them. Potential applicants who are unsure whether they meet the substance of any criteria or believe that failure to meet any requirement may not be material to their own case are encouraged to discuss their concerns with SFC Licensing staff before submitting an application.

3.2 The term substantial shareholder is used frequently in this document. It is used in the way that it is defined in section 2 of the SFC Ordinance and LFETO:

“substantial shareholder”, of a company, means a person, who, either alone or with an associate:

- (a) has an interest in shares in the company -
 - (i) the nominal value of which is equal to more than 10% of the issued share capital of the company;
 - (ii) which entitles the person, either alone or with an associate, and either directly or indirectly to exercise or control the exercise of more than 10% of the voting power at any general meeting of the company or;
- (b) holds shares in another corporation or corporations which holdings allow him either alone or with an associate and either directly or indirectly to exercise or control the exercise of 35% or more of the voting power of the other corporation, or of a further corporation, which is itself entitled either alone or with an associate and either directly or indirectly, to exercise or control the exercise of more than 10% of the voting power of the company.

3.3 The SFC is not likely to be satisfied that an applicant is a fit and proper person if, in the case of an individual, an accredited director^{*} or shareholder of a corporation, a sole proprietor or any member of a partnership, the person:

- (a) if applying for licence as an accredited director, is under 21 years of age; or, if applying for licence as a representative, is under 18 years of age;

Note: An applicant being under 21 years of age is one of the circumstances in which the SFC may refuse to license as an accredited director. It is unlikely that a person under 21 will have sufficient maturity and experience to be fit and proper to perform the duties of an accredited director.

- (b) is detained under the Mental Health Ordinance or is a patient, as defined in section 2 of that Ordinance;

Note: Again this is one of the circumstances in which the SFC may refuse to license an applicant.

- (c) was found to be of poor reputation, poor character, lacking in financial integrity and reliability, or dishonest. The weight given to events of the types listed below will depend on a number of factors, such as the time since the event, the seriousness of the event, and the category of licence sought. Instances which, if remained unexplained, might result in the applicant being regarded as having failed to meet this test are where the person has been (whether in Hong Kong or elsewhere):

- (i) found by a court or other competent authority to have acted fraudulently or dishonestly;

* An accredited director refers to a director or person nominated to be directly responsible for the supervision of the business of the licensee and who is actively participating in the licensed business.

- (ii) convicted of a criminal offence or is the subject of unresolved criminal charges which are of direct relevance to fitness and properness;

Note: This is one of the circumstances in which the SFC may refuse to license an applicant. In considering whether to license a person with a criminal record, the SFC would have regard to the nature of the offence and how recently it occurred. Older convictions may carry less weight, but regard must also be given to the position of the applicant within the firm.

- (iii) censured or reprimanded by, or denied/disqualified from membership of, a professional or trade body; or a regulatory licence, registration or similar approval has been refused or revoked;
- (iv) disqualified by a court of competent jurisdiction from being a director;
- (v) a substantial shareholder in, or involved in the management of, a corporation that was wound up (otherwise than by a solvent members' voluntary dissolution) or was otherwise insolvent or had a receiver or administrator appointed, however described;

Note: Obviously the extent of the person's involvement in the events surrounding the insolvency or similar event, and the person's behaviour in connection with the event, will have a substantial impact on the weight that the SFC attaches to the event in considering the person's fitness and properness.

- (vi) a substantial shareholder in, or involved in the management of, a corporation which was found guilty of fraud;

Note: As with insolvency events, the extent of the person's involvement in the relevant events, and the person's behaviour at that time, will have a substantial impact on the weight that the SFC attaches to the events in considering the person's fitness and properness.

- (vii) a substantial shareholder in, or involved in the management of, a licensed business which has not met all obligations to clients, compensation funds established for the protection of investors, or inter-member guarantee funds;

Note: Again the extent of the person's involvement in the relevant events, and the person's behaviour at that time, will have a substantial impact on the weight that the SFC attaches to the events in considering the person's fitness and properness.

- (viii) found culpable of insider dealing by the Insider Dealing Tribunal, or failed to abide by the Codes and guidelines promulgated by the SFC, other regulators or any relevant exchanges in Hong Kong or overseas (if applicable); or
- (ix) a substantial shareholder in, or involved in the management of, a corporation that has been found to have committed the acts described in (i), (iii) or (viii) above;

Note: Again the extent of the person's involvement in the relevant events, and the person's behaviour at that time, will have a substantial impact on the weight that the SFC attaches to the events in considering the person's fitness and properness.

- (d) is (whether in Hong Kong or elsewhere) an undischarged bankrupt, is currently subject to bankruptcy proceedings or is a bankrupt who has recently been discharged;

Note: This is one of the circumstances in which the SFC may refuse to license an applicant. In considering whether to license a bankrupt who has recently been discharged, the SFC would have regard to the circumstances of the discharge. Recency is normally taken to mean within the last 7 years for sole proprietors and accredited directors, and 3 years for representatives.

- (e) has failed (whether in Hong Kong or elsewhere) to meet any judgement debt;

Note: This test is related to the person's financial status, integrity and reliability. Again, the SFC would have regard to the circumstances of the failure to meet a judgement debt and the recency of the failure. Recency is normally taken to be the last 7 years for sole proprietors and accredited directors, and 3 years for representatives.

- (f) has failed to demonstrate that he is competent to perform the regulated activities efficiently and effectively;

Note:

- (i) *The SFC's general expectations are set out in its Guidance Note on Competence.*

- (ii) *Competence is assessed with reference to the applicant's educational and industry based qualifications together with relevant experience. It reflects the SFC's intention that licensed persons are equipped with the skills, knowledge and professionalism necessary to perform their duties. The level of knowledge expected varies according to the level of responsibility and the type of licence sought. Applicants are generally expected to be able to display an understanding of:*

- *the general structure of the regulatory framework that would apply to their activities if their application is successful;*
- *the particular legislative provisions, exchange rules, codes of conduct and guidance notes that apply to the functions that they would perform if licensed;*
- *the fiduciary obligations owed to clients and the general obligations owed to their employers or principals; and*
- *the financial products they deal in or advise upon and the market in which the service is provided.*

(iii) *The SO establishes minimum statutory experience or education requirements required of securities dealer:*

- *not less than 3 years experience in dealing in securities in Hong Kong or any other stock market recognised by the SFC; or*
- *having passed an approved examination (the examinations leading to associate or subscriber membership of the Securities Institute of Australia and for membership of, or registration as a representative or trader with, the International Stock Exchange of the United Kingdom and the Republic of Ireland Limited are currently the only two types of examination approved.)*

There are no legislative minima for the qualification and experience of advisers, commodity dealers, securities margin financiers and leveraged foreign exchange traders and their representatives.

The competence requirements as set out in the Guidance Note on Competence are somewhat higher than the statutory minimum. This is because the competence standards serve a different purpose from the legislation: the legislative provision sets an absolute floor level of prerequisite experience while the Guidance Note on Competence sets out the competence requirements that the SFC will adopt in assessing applications. These guidelines set out “average” rather than “minimum” requirements. Especially, the SFC considers it unlikely that person who is not competent can be fit and proper to be licensed.

- (iv) *Applicants for licence as an accredited director may be asked to attend an interview with SFC Licensing staff at which they will be expected to be able to provide general details of the compliance arrangements in their business. As well these interviews will provide an opportunity for SFC Licensing staff to obtain an understanding of the exact nature of the corporate applicant's business, which market segment the applicant is targeting, and any special and distinguishing features of the applicant's business.*

It should be noted that these interviews are not intended to be "verbal examinations", but rather to provide an opportunity for SFC Licensing staff to get a better understanding of the applications and the applicants' businesses.

- (g) has evidenced incompetence, negligence or mismanagement, which may have been indicated by the applicant having been (whether in Hong Kong or elsewhere):
- (i) censured or reprimanded by a professional, trade or regulatory body for negligence, incompetence or mismanagement; or
 - (ii) dismissed or requested to resign from any position or office for negligence, incompetence or mismanagement;

Note: Competence and efficiency are key elements to being fit and proper. However, the weight given to events of the types listed above in considering whether a person is fit and proper to be licensed will depend on a number of factors, such as the time since the event, the seriousness of the event, and the category of licence sought. As well, the source and quality of evidence will be taken into account; unsupported allegations by former employers will count for little, for instance.

3.4 In the case of a business (including sole proprietor, partnership and corporation), the SFC is not likely to be satisfied that the applicant is fit and proper if the firm:

- (a) is subject to receivership, administration, liquidation or other similar proceedings;
- (b) has failed (whether in Hong Kong or elsewhere) to meet any judgement debt;

Note: These are requirements aimed at identifying firms of dubious financial status, integrity and reliability. As with the same requirements in respect of individuals, the SFC would have regard to the circumstances of the failure to meet a judgement debt and the recency of the act. Recency is normally taken to be 7 years in this context.

- (c) is unable to meet financial resources requirements applicable to it on an ongoing basis;
- (d) has non-executive directors who fail to meet the requirements set out in paragraph 3.3 above other than that on competence to perform regulated activities;
- (e) has key personnel (such as executive directors and managers), substantial shareholders or other controllers that fail to meet the requirements set out in paragraph 3.3 above other than that relating to competence to perform regulated activities (unless such requirements are otherwise applicable);

Note: The SFC believes that all persons involved in the management or control of licensees must be honest, and of good character, reputation and financial integrity and reliability.

- (f) has not notified the SFC of an acceptable location where all records will be kept;

Note: This is one of the grounds in which the SFC may refuse licence under the SO and the CTO as amended by the SFC Ordinance. As noted above, the SFC places great importance on licensees having accurate accessible and secure records.

3.5

- (g) has failed to demonstrate that it is competent to perform the regulated activities efficiently and effectively.

Note: The competence standard generally expected by the SFC is set out in the Guidance Note on Competence. The competence of an applicant is generally assessed with reference to its organisational structure and personnel. The SFC is unlikely to be satisfied that the applicant is competent if its organisational structure and personnel:

- (i) *are unable to comply with the relevant legislative or regulatory requirements; or*
- (ii) *lack the infrastructure and internal control systems to manage risk effectively, avoid conflict of interest and provide proper audit trail.*

3.5 Although different businesses obviously need to be structured differently to take into account their own particular functions, size and culture, and operating systems will vary for similar reasons, there are some matters that must be addressed in every case:

- (a) at least one licensed person (the sole proprietor, an accredited director in the case of a corporation, or a partner in the case of a firm) must be directly responsible for, or actively participate in, the licensed business of the applicant;

Note: It is however suggested that a corporate applicant should nominate at least 2 persons to act as its accredited directors. This is to avoid the situation where the business has to be suspended because the sole accredited director is not available to supervise its activities either through illness or prolonged absence from the office.

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- (b) the responsibility or participation of the accredited director must include in its ambit compliance with legislative and other regulatory requirements (such as notifying the SFC of material changes; maintaining registers; books of account and other records; compliance with rules and ordinances relating to trading; issuing contract notes; compliance with margin rules; compliance with financial resources requirements...etc.);
 - (c) all persons associated with the applicant who are required to be licensed must be so licensed;
 - (d) there must be procedures to monitor on a regular basis continuing compliance with any financial resources requirements; and
 - (e) there must be an audit trail which enables past compliance with financial resources requirements and other applicable measures in accordance with relevant Codes and guidelines to be verified.

4.3

4. ADDITIONAL FIT AND PROPER CRITERIA FOR SECURITIES MARGIN FINANCIERS AND LEVERAGED FOREIGN EXCHANGE TRADERS

4.1 The matters set out in Chapter 3 are criteria that will apply to all applicants under the SO, the CTO and the LFETO. There are some additional criteria for companies applying for licence as securities margin financiers and leveraged foreign exchange traders.

4.2 The SFC will not be satisfied that a company is fit and proper to be licensed as a securities margin financier if it –

- (a) is not a company registered under the Companies Ordinance in Hong Kong; or
- (b) does not carry on the sole business of securities margin financing.

Note: The above are requirements under the SO.

4.3 The SFC will not be satisfied that a company is fit and proper to be licensed as a leveraged foreign exchange trader if it-

- (a) is not a limited company formed and registered in Hong Kong;
- (b) does not carry on the sole business of leveraged foreign exchange trading; or
- (c) does not specify all premises at which the business of leveraged foreign exchange trading will be carried out and at which any record or other document relating to the business is to be kept or fails to satisfy the SFC that the premises are suitable for record keeping.

Note: The above are requirements under the LFETO. Premises that are used wholly or partly for residential purposes shall not be regarded as suitable.

5. CONTINUING REQUIREMENTS

5.1 Licence under the SO, the CTO or the LFETO requires more than simply satisfying the initial and additional criteria. The SO, the CTO, the LFETO and the SFC Ordinance provide the SFC with powers to revoke or suspend licences, and to intervene and restrict licensed persons' activities in a number of ways. These powers are given to the SFC to enable it to take action to prevent licensed persons who are not fit and proper from remaining in business.

5.2 Pursuant to such powers, the SFC will consider revoking or suspending licence, or otherwise intervening in or restricting a licensed person's activities if:

- (a) it discovers that the person furnished information that is false or misleading in a material respect to the SFC in support of an application for licence, in an annual return or otherwise:
- (b) it has reason to believe that the person is no longer, or was never, a fit and proper person to be licensed, for instance if the person were detained under the Mental Health Ordinance, or if the person, or in the case of a corporation, a director or officer, is found to be of poor reputation, poor character, lacking in financial integrity, or dishonest in the ways set out in paragraphs 3.3 (c), (d), (e) or (g), or 3.4 (a) or (b) above.

However, unlike the case of initial applications, the onus of proof in respect of these matters lies with the SFC.

Note: These matters are ways of providing for revoking licences of persons who are not fit and proper.

5.3

5.3 Moreover, the SFC considers that any of the following actions must cast doubt on a person continuing to be fit and proper to remain licensed:

- (a) failure to observe and abide by all relevant laws, Codes of Conduct and Guidance Notes promulgated by the SFC and other regulators (if applicable);
- (b) failure to abide by the rules of any exchange of which it is an exchange participant;
- (c) knowingly or negligently aiding or abetting other persons in breach of relevant laws, exchange rules, Codes of Conduct and Guidance Notes;
- (d) failure to comply with the competence requirements as set out in the Guidance Note on Competence;
- (e) failure to comply with the continuous professional training requirements as set out in the Guidance Note on Continuous Professional Training.

Note: These requirements link licence to general “good citizenship” of the industry. As well, licensed persons must have procedures that are adequate to ensure that all the above are in compliance.

5.4 By way of example, to continue to be a fit and proper person to be licensed, the SFC considers that any licensee must:

- (a) not knowingly be a party to any insider trading or market manipulation; and
- (b) follow proper practice as set out in SEHK or HKFE or market Rules and Guidance Notes.

Note: These requirements are essential elements of best market practice.

5.5 Where the SFC is of the view that a licensee (or, in the case of a corporation, any director, secretary, or person concerned with the management of the corporation) has failed to meet the continuing fit and proper requirements set out in paragraphs 5.1 to 5.4 above, it may initiate an inquiry under section 56(1), section 121S and 121U of the SO, section 36(1) of the CTO, or section 12(1) of the LFETO to determine whether the licensee (or the director, company secretary or person concerned with the management of the corporation):

- (a) is or has been guilty of any misconduct in relation to the conduct of his business; or
- (b) is a fit and proper person.

5.6 If, after such an inquiry, the SFC is minded to take any action against a licensed person (such as reprimanding the person, or suspending or revoking the person's licence), the SFC must first give the person an opportunity to be heard. The reasons for any decision to take action against a licensed person must be notified to the person. If the person is dissatisfied with any decision, the person then has the right to take the matter to the Securities and Futures Appeals Panel.

SUPPLEMENTARY NOTES
to the Fit and Proper Criteria
for persons engaging in securities margin financing
under the Securities (Margin Financing) (Amendment) Ordinance 2000

I. Introduction

With the Securities (Margin Financing) (Amendment) Ordinance 2000 coming into effect on 12 June 2000, a person must not carry on a business or hold out to be carrying on a business of securities margin financing in Hong Kong unless that person is registered as a securities margin financier or is exempted from having to be registered as such. Likewise, an individual must not act as a representative of a securities margin financier unless that individual is registered as a securities margin financier's representative.

The Fit and Proper Criteria adopted by the Commission in assessing applicants applying for registrations under the Securities Ordinance and the Commodities Trading Ordinance will generally be adopted in vetting applicants for registration as securities margin financiers and securities margin financiers' representatives. Nevertheless, the areas of "relevant experience" for an individual applying to be an approved director under section 121I of the Securities Ordinance versus a dealer will differ taking into account the particular expertise required to operate a securities margin finance business. As well, there are additional criteria for securities margin financiers and dealers who engage in securities margin financing. The main differences are listed below:

II. Qualifications and Experience for Securities Margin Financier's Representatives

The Commission is unlikely to be satisfied that an individual is a fit and proper person to be registered as a securities margin financier's representative if that person

- is under 18 years of age; or
- has not completed educational level of Form 5 or its equivalent.

Note: Although experience is not a prerequisite for registration as a representative, two years experience either:

- (a) in a related field such as banking, or accountancy, or in a broker's back office; or*
- (b) in a position of responsibility,*

will compensate for an inability to meet the basic educational requirement of having completed Form 5 or its equivalent.

These requirements are basically the same as those applied to a dealer's representative or investment representative.

III. Qualifications and Experience for Securities Margin Financier's Representatives applying to be an approved director under section 121I of the Securities Ordinance

The Commission is unlikely to be satisfied that a director is fit and proper to be approved under section 121I of the Securities Ordinance if that person

- does not meet all the above requirements stated in above section II; or
- possesses less than 5 years **relevant** experience; or less than 3 years **relevant** experience plus relevant tertiary/industry qualifications; or
- does not have the ability to discharge the functions of a director.

Note: (a) Relevant experience would include margin financing, treasury and credit control at securities houses or financial institutions.

(b) Relevant tertiary or industry qualifications are not necessary conditions for registration. However, the SFC will require less experience from persons with such qualifications.

IV. Additional Criteria for Securities Margin Financiers

The Commission is unlikely to be satisfied that a company is fit and proper to be registered as a securities margin financier if it -

- (a) is not a company registered under the Companies Ordinance in Hong Kong;
- (b) does not carry on the sole business of securities margin financier;
- (c) is unable to comply with the financial resources rules applicable to it;
- (d) does not have a director approved by the Commission under section 121I of the Securities Ordinance; *(It is however suggested that a securities margin financier should nominate at least 2 directors to be directly responsible for the business. This is to avoid the situation where the business has to be suspended because the sole responsible person is not available to supervise its activities either through illness or temporary leave of absence from the office.)* or
- (e) does not have satisfactory internal control systems in place to ensure that it can comply with all applicable rules and regulations .

V. Additional Criteria for Securities Dealers engaging in securities margin financing

Under the Securities (Margin Financing) (Amendment) Ordinance 2000, a securities dealer is not required to be registered as securities margin financier in order to provide financial accommodation to facilitate acquisition or holding of securities for its clients, however, the Commission is unlikely to be satisfied that the business entity is fit and proper to undertake such activities if it –

- (a) is unable to comply with the financial resources rules applicable to it;
- (b) does not meet or, in the case of a corporation, does not have at least one dealing director who meets, the requisite requirements as stated in above section III; or

(c) does not have satisfactory internal control systems in place to ensure that it can comply with all applicable rules and regulations.

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