

**Consultation Document on the Draft Securities and Futures for the
Keeping of Records Rules**

Securities and Futures Commission
Hong Kong

February 2002

Consultation Document
The Draft Securities and Futures (Keeping of Records) Rules
(the “draft Rules”)

Introduction

1. Unlike the Securities Ordinance and the Commodities Trading Ordinance, the Securities and Futures Bill does not contain detailed record keeping requirements; it merely gives the SFC the necessary rule-making power under clause 147 to prescribe requirements in the subsidiary legislation. Effective regulation depends upon the regulator having the flexibility to quickly address changing market practices and global conditions, by amending the rules rather than the primary legislation.
2. There are controls built into the legislative system, whereby any rules made by the SFC must be subject to negative vetting by the Legislative Council. In addition, the SFC now releases the draft Rules (see Attachment 1) for public consultation.
3. The SFC has used the FinNet communication network to send copies of this consultation document to all intermediaries. In addition, the public may obtain copies of the consultation document free of charge at the SFC’s office and on the SFC’s Internet website at <http://www.hksfc.org.hk>.
4. The SFC invites market participants and interested parties to submit written comments on the draft Rules or to comment on related matters that might have a significant impact upon the draft Rules **no later than 15 March 2002**. Any person wishing to comment on the draft Rules should provide details of any organization whose views they represent. In addition, persons suggesting alternative approaches are encouraged to submit proposed text to amend the draft Rules.

Background

5. A copy of the draft Rules is attached. In short, the draft Rules require intermediaries and their associated entities to keep records containing sufficient details to explain their business activities and operations and account for their client assets.

6. The draft Rules have been prepared having regard to the existing section 83 and Division 6 Part XA of the Securities Ordinance, section 45 of the Commodities Trading Ordinance and section 3 of the Leveraged Foreign Exchange Trading (Books, Contract Notes and Conduct of Business) Rules. They are structured into two main parts – General Rules, Particular Rules with two schedules (one for certain intermediaries and the other for associated entities).

New Policy Initiatives

7. Several policy changes have been incorporated into the draft Rules:
 - (a) the draft Rules will apply to the records of all intermediaries and associated entities;
 - (b) intermediaries and associated entities should, where applicable, make entries in their records in accordance with generally accepted accounting principles;
 - (c) intermediaries and associated entities should reconcile balances and positions, at least monthly, with the statements provided by external parties including exchanges, clearing houses, other intermediaries, custodians and banks and the reconciling difference should be resolved;
 - (d) intermediaries should keep records to enable orders or instructions (whether filled or otherwise) to be traced through their trading, accounting, settlement and stock holding systems, where applicable;
 - (e) records kept by intermediaries and associated entities should demonstrate compliance with applicable provisions in the Ordinance and Rules made under the Ordinance and, where applicable, their systems of control for ensuring compliance thereof;
 - (f) intermediaries and associated entities should keep
 - (i) copies of contracts, order forms, confirmations, statements, registers, records, memoranda and correspondence made or received in the course of regulated activities for which they are licensed or exempt or, in the case of associated entities, in connection with receiving or holding of client assets;

- (ii) documents evidencing authorities provided by clients showing the period for which they are valid and evidence of renewal; and
 - (iii) particulars of clients who are professional investors and evidence of compliance with the relevant rules;
- (g) licensed corporations licensed for leveraged foreign exchange trading should keep records showing particulars of their recognized counterparties, including evidence to demonstrate compliance with the relevant rules;
- (h) records should be kept to explain all analyses and recommendations regarding the purchase, sale or other dealing in a specific security or futures contract;
- (i) similarly, Records should also be kept to explain work performed in rendering corporate finance advice to clients; and
- (j) the records kept by the intermediary licensed or exempt for asset management should have sufficient detail to show particulars of all clients' assets and liabilities including commitments and contingent liabilities.

Application of Rules

8. The draft Rules shall apply to all intermediaries and to the associated entities of intermediaries. "Associated Entity" is defined in Schedule 1 of the Securities and Futures Bill. At present, associated entities (typically the nominee companies within the same groups of companies as the dealers) are not subject to any regulation and the industry has indicated that this is a regulatory gap which needs to be filled.
9. We understand that some associated entities may not keep any records of their own as their related intermediaries are responsible for record keeping. This is considered acceptable; the definition of "keep" to also mean "cause to be kept" should provide enough flexibility to cater for this practice.

General Rules vs. Particular Rules

10. General Rules provide for how intermediaries or associated entities should keep their books and records. Particular Rules specify additional record keeping requirements for intermediaries licensed or exempt for certain types of regulated activities in order to reflect features peculiar thereto.

General Rules (Division 1 of Part II and Schedules 1 and 2)

11. Under the General Rules, intermediaries and associated entities must maintain records in sufficient detail and maintain records as specified in Schedules 1 and 2 respectively.
12. In general, intermediaries or associated entities are required to retain records for a period no less than 7 years except for certain types of trade-related documents which they are only required to retain for no less than 2 years.

Particular Rules (Division 2 of Part II)

13. The Particular Rules set out the additional record keeping requirements for intermediaries licensed or exempt for following types of regulated activities:
 - (a) dealing in securities;
 - (b) leveraged foreign exchange trading;
 - (c) advising on securities or futures contracts;
 - (d) advising on corporate finance;
 - (e) securities margin financing; and
 - (f) asset management.

Others matters

14. Please note that the names of the commentators and the contents of their submissions may be published on the SFC web site and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation document (see Attachment 2)

15. You may not wish your name and/or submission to be published by the SFC. If this is the case, please state that you wish your name and/or submission to be withheld from publication when you make your submission.
16. Written comments may be sent
 - By mail to: SFC (Keeping of Records Rules)
12/F, Edinburgh Tower
The Landmark
15 Queen's Road Central
Hong Kong
 - By fax to: (852) 2523 4598
 - By on-line submission: <http://www.hksfc.org.hk>
 - By e-mail to: keeping_of_records_rules@hksfc.org.hk
17. The draft Rules should be read in conjunction with the Securities and Futures Bill itself.
18. To better ensure that our proposed Rules appropriately balance investor protection and general market practice, the SFC has formulated the draft Rules after consulting selected registered persons. We wish to acknowledge and thank them for their invaluable input.