

16 December 2016

## **Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management**

### **A. Introduction**

1. General Principle 9 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) states that the “senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. In determining where responsibility lies, and the degree of responsibility of a particular individual, regard shall be had to that individual’s apparent or actual authority in relation to the particular business operations...”.
2. It is therefore important that the scope of each senior manager’s duties is clear and that each senior manager is fully aware of his or her obligations under Hong Kong’s regulatory regime.
3. This circular aims to:
  - (a) articulate the SFC’s view as to who should be regarded as members of senior management of licensed corporations (see Parts B and C);
  - (b) promote awareness of the regulatory obligations and potential liabilities of senior management (see Parts D and E);
  - (c) express the SFC’s general expectation that certain members of senior management should seek the SFC’s approval to be responsible officers (ROs) (see Part F);
  - (d) outline certain roles and responsibilities of a licensed corporation’s board of directors (Board) (see Part G); and
  - (e) provide more guidance as to the information a licensed corporation (or corporate applicant for a licence) should submit in respect of its human resources and organisational structure (see Part H).
4. The measures set out in this circular are consistent with the existing provisions of the Securities and Futures Ordinance (SFO), subsidiary legislation made by the SFC, and codes and guidelines published by it under the SFO.



## **B. Meaning of “senior management”**

5. The SFC is of the view that senior management of a licensed corporation includes, among others:
  - (a) directors<sup>1</sup> of the corporation,
  - (b) ROs of the corporation, and
  - (c) individuals whom we call the Managers-In-Charge of Core Functions (MICs), as elaborated in Part C.
6. These three categories are not mutually exclusive. For instance, an individual can simultaneously be a director, RO and MIC of a licensed corporation.

## **C. Managers-In-Charge of Core Functions**

7. For the purposes of this circular, the term “Manager-In-Charge of Core Function(s)” or “MIC”, refers to an individual appointed by a licensed corporation to be principally responsible, either alone or with others, for managing any of the following functions of the corporation (referred to as “Core Functions” and further explained in **Annex 1**):
  - (i) Overall Management Oversight
  - (ii) Key Business Line
  - (iii) Operational Control and Review
  - (iv) Risk Management
  - (v) Finance and Accounting
  - (vi) Information Technology
  - (vii) Compliance
  - (viii) Anti-Money Laundering and Counter-Terrorist Financing
8. The SFC considers that for each Core Function of a licensed corporation, there should be at least one individual appointed by the corporation as its MIC responsible for managing that function. However, the SFC recognises that licensed corporations may adopt different organisational and governance structures based on their commercial and operational needs. For instance, a licensed corporation may appoint one individual to act as the MIC for several Core Functions where appropriate considering its scale of operations and control measures. Also, a licensed corporation may appoint two or more individuals as MICs to jointly manage a particular Core Function (also see paragraph 28).
9. In determining whether an individual is an MIC of a particular Core Function, a licensed corporation should take into account the apparent or actual authority of that individual in relation to that Core Function. For example, an individual may be an MIC of a particular Core Function if he or she has one or more of the following attributes:

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<sup>1</sup> The term “director” is defined in Schedule 1 to the SFO to include a shadow director and any person occupying the position of director by whatever name called.



- (a) occupies a position within the corporation which is of sufficient authority to enable the individual to exert a significant influence on the conduct of that Core Function;
  - (b) has authority to make decisions (eg, assume business risks within pre-set parameters or limits) for that Core Function;
  - (c) has authority to allocate resources or incur expenditures in connection with the particular department, division or functional unit carrying on that Core Function; and
  - (d) has authority to represent the particular department, division or functional unit carrying on that Core Function, eg, in senior management meetings or in meetings with outside parties.
10. A licensed corporation should also take into account an individual's seniority. In this regard, the SFC generally expects that an MIC should:
- (a) report directly to the Board of the corporation, or to the MIC who assumes the Overall Management Oversight function of the corporation; and
  - (b) be accountable for the performance or achievement of business objectives set by the Board, or by the MIC who assumes the Overall Management Oversight function.
11. The SFC does not mandate any particular organisational or governance structure for licensed corporations. It is the responsibility of a licensed corporation's Board to determine the proper delegation of authority and responsibilities among its senior management (including MICs).
12. MICs will not necessarily be employees of the licensed corporation. However, they hold positions of authority within the licensed corporation, so they will not be external parties merely providing outsourced services. They may be located in Hong Kong or overseas. Furthermore, depending on the particular functions they perform in relation to the business of the corporation, they may or may not be licensed under the SFO.
13. The SFC does not seek to apply regulatory approval to an MIC who is not a licensed person or a licence applicant. However, a licensed corporation should ensure that any person it employs or appoints to conduct business is fit and proper and qualified to act in the capacity so employed or appointed (see Paragraph 4.1 of the Code of Conduct).

#### **D. Standard of conduct expected of senior management**

14. Various SFC codes and guidelines<sup>2</sup> provide guidance on the responsibilities of senior management of licensed corporations. In particular:

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<sup>2</sup> For example, the Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (Internal Control Guidelines), the Fund Manager Code of Conduct, the Corporate Finance Adviser Code of Conduct, the Code of Conduct for Persons Providing Credit Rating Services and the Guideline on Anti-Money Laundering and Counter-Terrorist Financing.



- (a) General Principle 9 of the Code of Conduct states that the senior management of a licensed corporation should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the corporation.
  - (b) Paragraph 14.1 of the Code of Conduct further specifies that senior management of a licensed corporation should:
    - (i) properly manage the risks associated with the business of the corporation, including performing periodic evaluation of its risk management processes;
    - (ii) understand the nature of the business of the corporation, its internal control procedures and its policies on the assumption of risk;
    - (iii) understand the extent of their own authority and responsibilities.
  - (c) The Internal Control Guidelines state that members of a licensed corporation's senior management, including its directors, chief executive officer, managing director or other senior operating management personnel (as the case may be), are ultimately responsible for the adequacy and effectiveness of the corporation's internal control systems. The Internal Control Guidelines also contain specific control guidelines for certain important areas, including information management, compliance, audit or related reviews, operational controls and risk management.
  - (d) The Guideline on Anti-Money Laundering and Counter-Terrorist Financing sets out detailed expectations regarding compliance and control functions that will be particularly relevant to MICs responsible for managing the Anti-Money Laundering and Counter-Terrorist Financing function.
15. Where policies, practices and actions are determined or formulated by or together with other companies in the group, the senior management of a licensed corporation should examine their appropriateness and make any necessary amendments or changes so that they are appropriate for the operations of the corporation's regulated business activities in Hong Kong.

## **E. Legal liabilities of senior management**

16. Under Part IX of the SFO, the SFC may exercise its disciplinary powers to sanction a regulated person if the person is, or was at any time, guilty of misconduct or is considered not fit and proper to be or to remain the same type of regulated person. The term "regulated person" means a person who is or at the relevant time was any of the following types of person:-
- (a) a licensed person;
  - (b) an RO of a licensed corporation; or
  - (c) a person involved in the management of the business of a licensed corporation (regardless of whether he or she is licensed).



17. All members of the senior management of a licensed corporation (even if they are not licensed) are regulated persons because of their involvement in the management of the licensed corporation's business.
18. Where a licensed corporation is (or was) guilty of misconduct as a result of the commission of any conduct occurring with the consent or connivance of, or attributable to any neglect on the part of, a person involved in the management of the business of the licensed corporation, then that person is also guilty of misconduct (see section 193(2) of the SFO).
19. "Misconduct" includes an act or omission relating to the carrying on of any regulated activity for which a person is licensed or registered which, in the opinion of the SFC, is or is likely to be prejudicial to the interest of the investing public or to the public interest. Before forming any opinion for this purpose, the SFC shall have regard to its various codes and guidelines (see section 193(3) of the SFO).
20. Furthermore, in determining whether a regulated person, including a person involved in the management of a licensed corporation, is a fit and proper person for the purpose of considering taking disciplinary action, the SFC may, among other matters, take into account the past or present conduct of the person (see section 194(3) and section 129 of the SFO). For instance, if an MIC fails to ensure a licensed corporation's compliance with the codes or guidelines published by the SFC, the failure may call into question the MIC's fitness and properness, having regard to his or her level of responsibility within the firm.
21. Whether the SFC is to discipline a regulated person depends on the specific facts of each case. In determining where responsibility lies, and the degree of responsibility of a particular member of senior management, the SFC will take into account the individual's apparent or actual authority in relation to the particular business and operations, his or her level of responsibility within the licensed corporation concerned, any supervisory duties he or she may perform, and the level of control or knowledge he or she may have concerning any failure by the corporation or persons under his or her supervision to follow the Code of Conduct (see General Principle 9 and Paragraph 1.3 of the Code of Conduct).
22. The disciplinary sanctions which the SFC may impose on a regulated person under Part IX of the SFO (eg, licence revocation or suspension, pecuniary fine and reprimand) are civil rather than criminal in nature. In addition to potential disciplinary sanctions, senior management of licensed corporations should also be aware of potential criminal liability. When a corporation (which may or may not be a licensed corporation) has been found guilty of an offence under the SFO, under section 390(1) of the SFO, where the offence is proved to have been aided, abetted, counselled, procured or induced by, or committed with the consent or connivance of, or attributable to any recklessness of, any officer of the corporation, then that officer is also guilty of the offence.

#### **F. MICs who head certain Core Functions should be ROs**

23. The SFC generally expects that MICs of the Overall Management Oversight function and the Key Business Line function should be ROs in respect of the regulated activities



they oversee. This is because, in most cases, MICs of these Core Functions actively participate in or are responsible for directly supervising the business of the regulated activities. For the avoidance of doubt, the SFC does not expect MICs of Core Functions other than these two to be ROs. The SFC also does not require every RO to be an MIC.

24. In considering whether an RO applicant, who is or will be an MIC of the Overall Management Oversight function, meets the industry experience tests set out in the Guidelines on Competence, the SFC takes into account, among other things, the applicant's overall career history within the industry, as well as his or her proposed activities and the resources (including system and expertise) available to the licensed corporation in totality. An applicant who has held a senior position to manage a control or operational function (eg, risk management, compliance, financial or operational control) for a long time may be approved as RO subject to appropriate licensing conditions, even if he or she has not had any experience in conducting or directly supervising regulated activity. Typically in this situation, a licensing condition may be imposed to the effect that he or she should work together with another RO who is fully competent. After accumulating sufficient experience in regulated activity, he or she may apply for waiving the licensing condition under section 134(1) of the SFO. The SFC will consider every RO application or waiver application based on the specific facts of the case.
25. As regards licensing examinations, Appendices D and E to the Guidelines on Competence currently provide various exemptions from the recognised industry qualification requirement and the local regulatory framework paper requirement. For instance, an RO applicant, who is assuming a very senior management position in a licensed corporation, may be exempt from taking the local regulatory framework paper if he or she has sufficient industry experience and there is regulatory support available to him or her from other personnel within a controlled environment.<sup>3</sup>

## **G. Roles and responsibilities of the Board**

26. The Board of a licensed corporation has the ultimate responsibility for the conduct, operations and financial soundness of the corporation. The Board works with senior management (including MICs) to achieve the objective of a soundly and efficiently run corporation, and senior management is accountable to the Board.
27. Any member of the Board (regardless of whether he or she plays an executive or non-executive role with respect to the business of the licensed corporation) has a duty to exercise independent judgement in relation to the exercise and delegation of the Board's powers. The Board retains responsibility for delegated decisions and is required to have systems and controls in place to supervise those who act under the delegated authority.
28. The Internal Control Guidelines state that a licensed corporation should establish, document and maintain an effective management and organisational structure. To this end, the SFC expects that a licensed corporation should adopt a formal document, approved by the Board, clearly setting out the management structure of the corporation,

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<sup>3</sup> See Paragraph 6, Part II, Appendix E of the Guidelines on Competence.



including the roles, responsibilities, accountability and reporting lines of its senior management personnel. Where a licensed corporation designates more than one individual to be the MICs of a particular Core Function, the Board should ensure that the aforesaid document contains sufficient details regarding the specific responsibilities of each MIC concerned. The SFC may request a licensed corporation to provide the document for its review. Certain key information regarding a licensed corporation's management structure should be submitted to the SFC under the Securities and Futures (Licensing and Registration)(Information) Rules (Information Rules), as further explained in Part H.

29. The management structure of a licensed corporation (including its appointment of MICs) should be approved by the Board of the corporation. Furthermore, the Board should ensure that each of the corporation's MICs has acknowledged his or her appointment as MIC and the particular Core Function(s) for which he or she is principally responsible.

## **H. Submission of management structure information**

30. When applying for a licence under section 116(1) of the SFO, a corporation is required to provide information about its human resources and organisational structure showing that it is capable of carrying on regulated activities competently.<sup>4</sup> This information is relevant to the SFC's assessment, under section 129 of the SFO, of the corporation's fitness and properness for carrying on regulated activities. It is also relevant to the performance of the SFC's other regulatory functions, including ongoing intermediaries supervision and enforcement. Accordingly, the SFC expects the corporation to provide information regarding its MICs and its organisational chart in its application.
31. In respect of each of its MICs, the corporation should submit the following particulars:
  - (a) full name;
  - (b) identification information;
  - (c) job title<sup>5</sup>;
  - (d) place of residence;
  - (e) the Core Function(s) which he or she is in charge of; and
  - (f) the job title(s) of the person(s) to whom he or she reports within the corporation and, if applicable, within its corporate group.
32. In addition, the corporation should submit an organisational chart depicting its management and governance structure, business and operational units and key human resources and their respective reporting lines. The chart should capture all MICs engaged by the corporation, their respective reporting lines (as described in paragraph 31, item (f)) and the job titles of the persons reporting directly to these MICs in relation to the operations of the corporation.

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<sup>4</sup> See section 3(1)(a) and Part 1 of Schedule 2 (items 11 and 12) of the Information Rules.

<sup>5</sup> The job title should indicate an individual's position and his or her particular business or operational area (eg, Chief Executive Officer, Chief Investment Officer, Chief Administrative Officer, Head of Risk Management, Head of Corporate Finance).



33. A licensed corporation should notify the SFC of any changes in its appointment of MICs (including any new appointment and cessation of appointment) or any changes in the particulars of its MICs (see paragraph 31) within seven business days of the changes. Where a change involves a new appointment or cessation of appointment, or a change in the particulars referred to in items (e) and (f) of paragraph 31, the licensed corporation should also submit an updated organisational chart in its notification of that change.<sup>6</sup>
34. The Board of a licensed corporation or a corporate licence applicant should ensure that the information submitted to the SFC is complete and accurate. Under section 383 or 384 of the SFO, a person may commit an offence if he provides false or misleading information in support of a licence application or in relation to a notification (as the case may be).
35. To facilitate the submission of the required MIC information and organisational charts by corporations applying for a licence under section 116(1) of the SFO, the SFC will (a) revise the existing form, Supplement 8 – Business Plan and Proposed Business Activities, and (b) make a new form, Supplement 8A – Manager-In-Charge of Core Function(s). A draft of the new Supplement 8A is at **Annex 2** for reference.
36. Upon implementation of these measures, we will expect existing licensed corporations to submit the required information about their MICs and their organisational charts via the SFC Online Portal. Any subsequent changes (as mentioned in paragraph 33) should also be submitted to the SFC via the SFC Online Portal.
37. The SFC will, by notice published in the Gazette, specify the revised Supplement 8 and the new Supplement 8A as well as the related online portal forms (for both application and notification purposes) under section 402 of the SFO.

## I. Implementation

38. The SFC understands that some licensed corporations may need time to revisit their management structures and RO appointments in light of the matters outlined in this circular. The SFC intends to commence the information collection initiative (outlined in Part H) on 18 April 2017 (**commencement date**).
39. Before the commencement date, the SFC will organise industry workshops to introduce the new features of the SFC Online Portal for submitting the MIC information and organisational charts. The SFC will expect licensed corporations to submit the MIC information and organisational charts within three months from the commencement date (ie, on or before 17 July 2017).
40. The SFC generally expects that on or before 16 October 2017 (ie, within six months from the commencement date), MICs of the Overall Management Oversight function and the Key Business Line function, who are not already ROs, will have applied for approval to become ROs (see Part F).

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<sup>6</sup> See section 4 and Part 1 of Schedule 3 (item 9) of the Information Rules.



41. Alongside this circular, the SFC has published on its website a series of Frequently Asked Questions under the topic “Measures for augmenting senior management accountability in licensed corporations”.

**Intermediaries Division**  
**Securities and Futures Commission**