

**Consultation Conclusions on
The Draft Securities and Futures
(Licensed Persons And Registered Institutions) Rules**

**Securities and Futures Commission
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Introduction

1. A draft Securities and Futures (Licensed Persons And Registered Institutions) Rules (“the Rules”) was published by the Securities and Futures Commission for public consultation on 16 November 2001. This document summarizes the responses received and the Commission’s conclusions.
2. The consultation period ended on 17 December 2001. A total of 7 submissions were received from market participants and other organizations (listed in Annex). These submissions have been published in the Commission’s website at <http://www.hksfc.org.hk>.
3. In addition to comments and suggestions, certain respondents sought clarification on a number of issues. Clarifications will be incorporated into the Rules wherever appropriate.

Consultation Responses and Conclusions

4. This section sets out a summary of the main consultation responses and should be read in conjunction with the Rules. References are made to the specific paragraphs as they appear in the Rules.

Rule 4 – General requirements for documents lodged with the Commission

Comments on Rule 4(2) - signatures

5. One respondent commented that the Rule had not clarified as to who might sign a document on behalf of a licensed corporation/registered institution. The respondent further queried whether the Commission would allow other persons approved by the firms as having signing authority.
6. Two respondents observed that the requirement for electronic submissions to be accompanied by digital signatures was not specified.
7. One respondent commented that supplementary information provided to the Commission by e-mail should not require signatures, or such to be followed by hard copies. The current practice does not so require.

The Commission's response

8. The Commission takes the view that the documents or forms, apart from the responsible/executive officers, can also be signed by a person authorized by the firm's board of directors. This will be indicated in the relevant forms.
9. In line with the current requirement, digital signatures should be required in respect of submissions made via electronic means. The Commission will propose an amendment to this effect. However, as regards supplementary information provided via email, we will adopt a pragmatic approach, as has always been the case. Each case will be considered on its own merits.

Comments on Rule 4(3) – the term “substantial practical difficulties”

10. One respondent commented that the Rule should define more clearly the circumstances that would amount to “substantial practical difficulties” in submitting the required document within the relevant time. It considered prompt reporting from intermediaries to be in the interest of investors.

The Commission's response

11. The Commission will adopt a pragmatic approach in interpreting the term (as has been its general practice) and will consider each case on its own merits.
12. Further, as Rule 4 applies to all documents lodged with the Commission and not only those lodged by licensed persons and registered institutions, the Commission will move the provisions of Rule 4 to the Securities and Futures (Miscellaneous) Rules.

Rule 5 – Particulars to be entered in the register of licensed persons and registered institutions

General Comments

13. One respondent observed that it seemed strange that the Commission, and not the Hong Kong Monetary Authority (“HKMA”), would undertake

the task of receiving and administering information on registered institutions when supervisory jurisdiction of such institutions was vested in the HKMA. The respondent suggested for the HKMA to maintain such register, and for the setting up of an information cross-referencing mechanism (such as a hyperlink) between the two regulators.

14. The respondent further suggested that intermediaries' website addresses (where available) should be included in the register, as investors might find this information useful.

The Commission's response

15. The Commission is required to maintain a register which captures pertinent information relating to market intermediaries. We welcome the suggestion regarding the information cross-referencing mechanism and have been working with the HKMA to take this matter further.
16. We also think that the inclusion of web-site and email addresses (where available) in the register desirable. We will propose an amendment to this effect.

Comments on Rule 5(2)(g) - disciplinary record

17. Three respondents commented on this area. All supported the disclosure of disciplinary actions taken against intermediaries. One respondent advocated for the retention of such information indefinitely (as practised by the National Association of Securities Dealers of the United States), while another respondent believed that the disclosure period should not be longer than five years and further questioned the propriety of adopting a blanket period of disclosure of all types of disciplinary actions.
18. One respondent commented that the Rule was unclear as to what was being meant by the term "disciplinary history" mentioned in the consultation document.
19. One respondent noted that under the provisions of the Rehabilitation of Offenders Ordinance, certain offences became spent after only a three-year period. If the five-year limit were to be introduced, the respondent would expect this to be reflected in the licensing application process by which disciplinary actions over five years old would become "spent" and not need to be disclosed.

The Commission's response

20. Balancing the different views and practices in this regard, the Commission thinks that the disclosure of 5 years' disciplinary record is appropriate. A standardised approach will be easily understood by all stakeholders. It is not the Commission's intention to go beyond what would normally be available from its press releases on disciplinary actions. In any event, minor breaches that do not warrant public disciplinary action will not be disclosed. We will clarify in the Rule that the term "disciplinary record" is confined to public disciplinary actions taken by the Commission.
21. As regards "spent" disciplinary records, the Commission has always taken the view that each and every application should be considered on its own merits. As the proposed disclosure seeks to enhance the openness and transparency of the market, it should not fetter the licensing application process. We may also add that the Fit and Proper Criteria published by the Commission states that a general recency test of seven years may be adopted.

Comments on Rule 5(3)(c) - complaints officer

22. One respondent was not persuaded that it would be helpful to include the name of the complaints officer on the register. It suggested that it would be preferable to require each corporation to set up a specific function responsible for dealing with complaints under an employee holding the title of "Complaints Officer". This would allow complainants to write to the assigned officer without needing to know the individual's name. It would give firms the flexibility to change the identity of the appointee without having a duty to make a formal notification. The respondent was also concerned in having to expose such an employee to the resulting level of publicity.
23. Another respondent commented that having the names of the responsible officer and complaint officer appearing on the register might mean unnecessary administrative burden on the officers. It might also lead to the abuse of such information. The alternatives of a complaints hotline, and the provision of the names of such officers to the Commission only, might be considered.
24. One other respondent echoed the above sentiments.

25. However, two respondents supported the proposal. One suggested that the Commission should require licensed corporations to set up extensive internal complaint handling procedures, while the other suggested that such officer should ideally be independent of the business functions.

The Commission's response

26. Having carefully re-examined the issue, we came to the view that the Rule may be amended to require the disclosure of only the contact details of the assigned complaints officer in the register. We believe that this approach would facilitate the provision of investment services by intermediaries without compromising protection of investors. With respect to the firms' complaint handling procedures, these are covered in the Commission's Code of Conduct (section 12.3) and the Management, Supervision and Internal Control Guidelines (paragraph 5 of Section V), which will also be updated in the light of the Bill (enacted as the Securities and Futures Ordinance on 13 March 2002) and relevant subsidiary legislation.

Comments on Rule 5(6) - particulars to be entered in the register

27. Two respondents suggested that the Commission should be required to update the register regularly, with one commenting that failure on the Commission's part to do so would negate the value of the register.

The Commission's response

28. The Commission has always taken its functions seriously and endeavored to promptly process relevant data received from licensees. As a matter of practice, the current register is updated automatically (via a computer system) on a daily basis. We will continue to ensure the integrity of the register.

Rule 6 - Correction of errors

Comments

29. One respondent commented that the use of the word "may" in this paragraph did not place an obligation on the Commission to correct

errors on the Public Register. It recommended that the word should be replaced with “will” or “shall”.

The Commission’s response

30. The proposed wording is in accordance with the existing Rules. However, we will change it to “will”, “shall” or “must”.

Rule 7 – Licence or certificate of registration to be exhibited

Comments

31. One respondent believed that it was not necessary for intermediaries to exhibit their certificates as the licensing details would be found in the register accessible via the Internet. Another respondent commented that it was not necessary to so exhibit provided that the certificates could be made available for inspection. It added that the requirement did not assist where an intermediary had offices in different locations or where the licence was put on display in a non-prominent place.

The Commission’s response

32. The Commission notes that not all members of the public have ready access to the Internet to obtain relevant information from the Commission’s website. Furthermore, displaying the certificates would facilitate transparency. The Commission will propose amending this Rule requiring each firm to exhibit its certificate in a prominent place at its principal place of business, and a certified copy at each of its other places of business.

Rule 8 – Return of licence or certificate of registration

Comments on Rule 8(1) - cessation of regulated activities

33. One respondent commented that the current language was ambiguous as to the extent of “cessation” that would trigger the return of the licence. It further questioned whether the cessation needed to be permanent to trigger such requirement.

34. Another respondent commented that an intermediary might cease to engage in regulatory activities for a short period of time. He should not, under such circumstances, be required to return the certificate. The phrase “ceases to engage in regulated activities” might be replaced by “intends to cease to carry on any regulated activity”.
35. One other respondent supported the proposal and suggested that the certificates should be returned immediately upon cessation of regulated activities.

The Commission’s response

36. The Commission does not expect an intermediary to return his certificate in respect of a temporary cessation of regulated activities for reasonably a short period. The Rule will be amended to reflect this expectation. In the interest of investor protection, we further agree with the suggestion for the immediate return of certificates upon cessation of regulated activities, and in any event, not later than seven days.
37. Further, cessation cases may include ceasing to carry out one of a number of regulated activities, ceasing to act for one of a number of principals (usually within the same group of companies), or ceasing to carry out business altogether. The immediate return of certificates in such cases is also appropriate.

Rule 9 – Changes to be notified by licensed persons and registered institutions

General Comments

38. One respondent suggested that the application forms should be consistent with the matters set out in this Rule. It further assumed that the Commission would issue a revised Licensing Information Booklet to outline the various notification requirements under clause 132 of the Bill and the Rules.

The Commission's response

39. The Commission will ensure that the relevant forms are consistent with this Rule. We will also revise the Licensing Information Booklet as assumed.

Comments on Rule 9(1) – notification in writing within 7 days

40. One respondent commented that given the size and geographical spread of an international group, it might be difficult to notify the Commission of reportable changes in associated companies within such a short period of time. It suggested for the changes in associated companies that operate in Hong Kong to be reported within 7 days, and changes in associated companies operating overseas to be provided quarterly.
41. One respondent suggested that, in the context of the information required, the time limit should be 7 days from the date of knowledge of the change, rather than of the change itself. A corporation might not become aware that a director had been charged with a criminal offence but the time limit for disclosure would commence from the date the director was charged. The respondent appreciated that this would require an amendment of section 132(3) of the Bill, but believed that this was particularly important given that the failure to comply was an offence punishable by a fine.

The Commission's response

42. The Commission considers prompt notification to be important and is required on investor protection grounds. Licensees that fail to comply will be considered on a case by case basis, including consideration of any reasonable excuse.

General comments on Rule 9(2) & Rule 9(3) – notification of changes

43. One respondent invited the Commission to reconsider the differences in treatment between registered institutions and licensed persons in terms of the information required to be notified, bearing in mind the rationale of leveling the playing field between the two categories.
44. One respondent commented that the drafting of these Rules should be tightened in the interests of clarity. Rule 9(2) was intended to be a list of matters, changes to which had to be notified to the Commission.

However, when combined with Rule 9(1), Rule 9(2)(h) placed an obligation on a licensed corporation to disclose changes in “issues relating to its fitness and properness”, which was unclear. Likewise, Rule 9(2)(k) pertaining to changes in “business activities” was also not clear.

The Commission’s response

45. The Commission notes the level playing field issue and will amend the Rules ensuring similar treatment wherever feasible. Rule 9(3) will be amended to also require registered institutions to notify changes in contact details of any assigned complaints officer, status of membership of a stock or futures exchange, issues relating to fitness and properness, and material changes in regulated business activities.
46. We will also amend these Rules where appropriate to specify the information required. In Rule 9(2)(h), the word “including” will be deleted.

Comments on Rule 9(2)(b) – contact details

47. A respondent observed that it was not common in firms having an electronic mail address. It further assumed that it was not mandatory to provide one.

The Commission’s response

48. An electronic mail address is not a mandatory requirement. However, firms are required to provide such information if they have one.

Comments on Rule 9(2)(d) – emergency contacts

49. One respondent questioned the usefulness of having a night time electronic mail address for the persons who were to be the Commission’s point of contact in the event of a market emergency or other urgent needs. Another respondent suggested that the contact person be principally based in Hong Kong.

The Commission's response

50. The requirement aims to provide an alternative means of communication for emergency situations after office hours. The Commission expects the contact person to be either principally based in Hong Kong and/or that person should be well versed with the firm's operation.

Comments on Rule 9(2)(h) - issues relating to fitness and properness

51. One respondent commented that the requirement on a licensed corporation to notify issues affecting its fitness and properness might be perceived by market participants as being too onerous in a number of respects.
52. One respondent commented that the disclosure requirements in relation to fitness and propriety should be consistent with the notification requirements imposed by the Code of Conduct. The respondent asked what interaction between the Code of Conduct and this Rule had been proposed upon its coming into force.

The Commission's response

53. The Commission thinks that the notification requirement should not be too onerous, as such occurrences should be uncommon. In addition, corporations that fail to notify promptly will be considered on a case by case basis, including consideration of any reasonable excuse.
54. The Commission notes the comment and will update the Code of Conduct to ensure consistency.

Comments on Rule 9(2)(h)(i) - criminal offence of directors

55. One respondent queried whether a firm would be in breach of the Rule if its failure to disclose resulted from a director failing to internally notify the firm of a matter set out in the Rule. It also commented that the Rule would require each licensed corporation to set in place an internal compliance reporting structure which might be both difficult and expensive to administer. Such a requirement would be tantamount to an internal and external "whistle-blowing" obligation that arguably went beyond the original regulatory rationale.

56. One respondent commented that it seemed unduly broad to require notification when any director or responsible officer has been charged with a criminal offence. Currently, notification was not required in respect of traffic offences, and that should be retained.

The Commission's response

57. The Commission expects licensed corporations to implement an appropriate internal compliance reporting structure to ensure prompt reporting of relevant information. This is in the interests of protecting investors, the integrity of the market, and the firms' operations. Again, any breach will be considered on a case by case basis, including consideration of any reasonable excuse and all the facts and factors underlying the contravention. In the case of a licensed corporation or registered institution failing to notify changes in information pertaining to its directors or connected persons, the Commission would consider, amongst others, whether such information had been reported to the corporation or institution.
58. It is not the Commission's intention to require the disclosure of minor traffic offences. However, serious ones should be reported. The Commission will propose an amendment to this effect.

Comments on Rule 9(2)(h)(ii) – disciplinary proceedings

59. One respondent commented that it was unclear at what point a director or responsible officer would be required to disclose an "involvement" in disciplinary proceedings, and when the 7-day notice period ran. It suggested that notification should be required only when the disciplinary proceedings had been concluded and the outcome of the proceedings made public.
60. One respondent commented that it was unclear whether "disciplinary proceedings" extended to cover inquiries carried out by regulatory organizations before disciplinary action was recommended. It was preferable for the Commission to receive details of material on-going inquiries rather than solely disciplinary proceedings.
61. Another respondent recommended the replacement of the words "involved in" with "the subject of" to avoid the reporting requirement in cases where the person acted as a witness.

The Commission's response

62. The Commission takes the view that “disciplinary proceedings” should cover inquiries carried out by regulatory organizations prior to disciplinary action being recommended. To wait until the proceedings had been concluded would very much undermine the Commission’s functions. An amendment will be made to clarify this matter. The words “involved in” will also be replaced by “the subject of”.

Comments on Rule 9(2)(h)(iii) - judicial or other proceedings

63. One respondent requested confirmation that disclosure was only required where the judicial proceedings were material or relevant to a person’s continuing fitness and propriety.
64. One respondent commented that the requirement for notification when a person was engaged in “any judicial or other proceedings, whether in Hong Kong or elsewhere” was too wide and vague. It suggested for the inclusion of some de minimis provisions so that, for example, it was not necessary to make a notification whenever proceedings were commenced for small amounts owing to the licensed corporation. Another respondent also commented on the broad scope of the requirement. It believed that some attempt could be made to qualify the scope of this Rule so as to limit it to relevant matters.

The Commission's response

65. The Commission notes the comments. It has always been our practice to only require the disclosure of relevant and material details. The Rule will be amended to this effect.

Comments on Rule 9(2)(h)(iv)- solvency

66. One respondent noted the overlap with the notification requirement in paragraph 12.5(b) of the Code of Conduct, which provided greater clarity.

The Commission's response

67. The Code of Conduct and other guidelines were issued to help clarify the requirements under the various statutory provisions.

Comments on Rule 9(2)(h)(v) – any other matter

68. One respondent commented that the requirement was broader than that found in the current legislation and was not specific. It recommended that details of matters in relation to fitness and propriety should be specified.

Comments on Rule 9(2)(h)(iv) & Rule 9(2)(h)(v)

69. One respondent commented the “catch-all” provision was very broad-ranging. In addition to imposing a heavy ongoing burden on intermediaries, the judgmental element made it very difficult to ascertain the extent of the reporting obligations. It recommended confining the required information to those matters which could be objectively identified.

The Commission’s response

70. Although the preceding paragraphs of this Rule have listed out the specific information required, it may not be possible to cover all circumstances. Therefore, these two items are required, and they aim to encourage licensees to make disclosure. As has always been the case, the Commission will adopt a pragmatic stance in administering this Rule.

Comments on Rule 9(2)(j) – the corporation’s bank accounts

71. One respondent commented that it was unclear as to the meaning of changes to the “corporation’s bank accounts”.

The Commission’s response

72. The Commission requires certain pertinent information relating to all active bank accounts of corporate licensees. The required information will be specified in the licence application form.

Comments on Rule (9)(2)(k) – changes in business activities

73. One respondent commented that the drafting of this Rule was somewhat obscure. It would be more straightforward to refer to significant

changes to the conduct of business in any regulated activity for which the corporation was licensed.

The Commission's response

74. The Commission accepts the recommendation and will amend this Rule accordingly.

Comments on Rule (9)(2)(l) & Rule 9(3)(g) - details in relation to associated entities

75. One respondent observed that there was no reason for the requirement to notify the circumstances under which an entity became an associated entity.
76. Another commented that with respect to the term “associated entities”, a 20% control threshold was too low and the inclusion of 20% commonly-controlled sister companies might be casting the net too wide, particularly where the 20% sister company was engaged in an unrelated business and/or operated outside Hong Kong. The definitions of “associated entities” and “controlling entity” in the Bill were very broad. The respondent questioned the propriety of using these terms in this context. It was also not clear why the Commission and the HKMA required such information. In addition, to impose such a disclosure obligation on intermediaries might be unrealistic, as it might be practically difficult for intermediaries to obtain the required information from upstream or sister associated entities given the 20% control threshold. The respondent suggested an annual or periodic disclosure requirement to reduce the administrative burden on intermediaries.

The Commission's response

77. The requirement on the circumstances under which an entity became an associated entity reflected the requirement under section 161(1)(a) of the Bill.
78. Owing to the role of associated entities in safeguarding intermediaries' client assets, the Commission thinks that the on-going reporting requirement is a reasonable one. It also should not place an onerous burden on the intermediaries as associated entities should not change too often.

Comments on Rule 9(4)(b) - status of any authorization outside Hong Kong

79. One respondent suggested that the information requested in this Rule should be provided in the annual return rather than within 7 days.

The Commission's response

80. Prompt notification of an individual's authorization status in other jurisdictions enables us to carry out supervisory functions more effectively.

Comments on Rule 9(4)(d)(i) - criminal offence

81. One respondent requested the Commission to confirm whether the criminal offences referred to only covered those that went to an individual's fitness and propriety. It might not be appropriate to require an individual to disclose a traffic offence. The current position did not so require.

The Commission's response

82. Individuals are not expected to disclose details of minor traffic offences. The Commission will propose an amendment to this Rule.

Comments on Rules 9(4)(d)(ii) & (iii) - disciplinary and judicial proceedings

83. One respondent commented that the requirement upon a licensed person to disclose any judicial or other proceedings in which he was engaged without reference to the materiality or relevance to the person's fitness and propriety was inappropriate.

The Commission's response

84. The Commission agrees with the comment and will amend Rule 9(4)(d)(ii) and Rule 9(4)(d)(iii), and to ensure their consistency with Rule 9(2)(h)(ii) & Rule 9(2)(h)(iii).

Other comments on the Rules - sanctions for breaches

85. One respondent commented that it was not clear as to the sanctions that would result from a breach of the Rules, while another respondent suggested that the sanctions for non-compliance should be clearly stated.

The Commission's response

86. The Commission takes the view that any breach of the Rules by licensed persons and registered institutions may constitute misconduct under Part IX of the Bill. However, the Commission would, as in the past, take into account whether the breach is due to substantial practical difficulties experienced by the person concerned. In the case of a licensed corporation or registered institution failing to notify changes in information pertaining to its directors or connected persons, the Commission would consider, amongst others, whether such information had been reported to the corporation or institution. Section 132 of the Bill provides that a contravention of Rule 9 (on changes to be notified by licensed persons and registered institutions), without reasonable excuse, may constitute an offence. However, all the facts and factors underlying the contravention in each case have to be taken into account, and that an offence is committed only if the contravention is without reasonable excuse.

Other Issues

87. One respondent commented that certain issues such as the deposit of security, and rules on stock borrowing and lending arrangements, were not dealt with in the Rules. It assumed that the Commission would make separate rules to deal with those issues.

The Commission's response

88. Those issues will be addressed either in separate rules or codes to be issued by the Commission.
89. Finally, the Commission would like to thank the respondents who have made valuable suggestions and comments.

Annex

The list of respondents in alphabetical order :

1. Baker & McKenzie
2. Consumer Council
3. Freshfields Bruckhaus Deringer
4. JF Asset Management Limited
5. Linklaters (on behalf of 5 firms)
6. Lloyds TSB Pacific Limited
7. A licensee