

This newsletter provides guidance to licensed corporations, registered institutions and other market practitioners on the SFC's regulatory and supervisory priorities.

## Our gatekeeping function

The SFC has a statutory obligation to license only fit and proper persons to conduct regulated activities under the Securities and Futures Ordinance (SFO). The Licensing Department of the SFC's Intermediaries Division is charged with this gatekeeping function to protect the interests of investors and maintain market integrity.

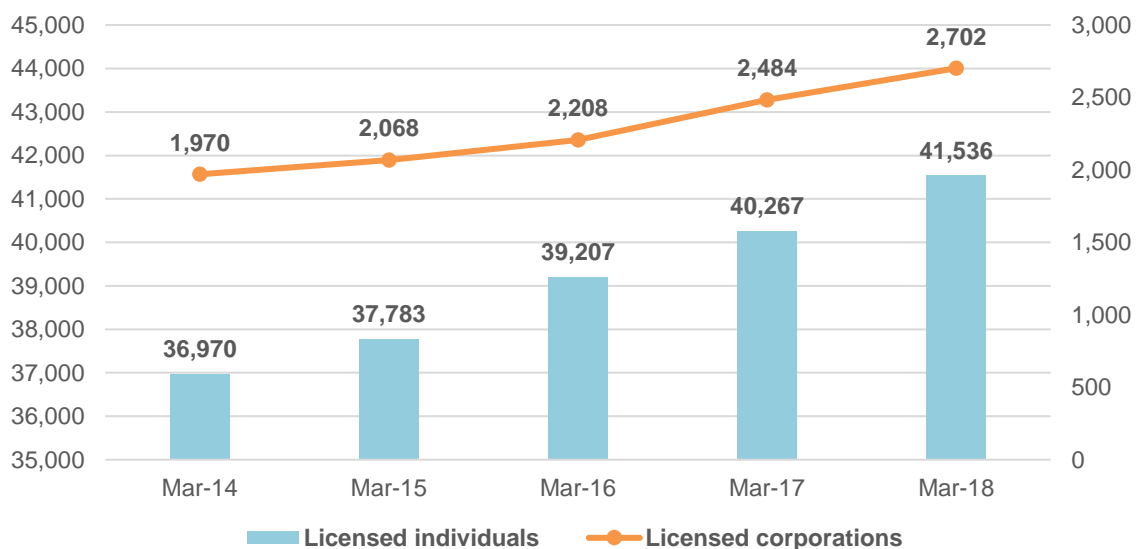
This edition of the *SFC Compliance Bulletin* highlights key trends noted in the SFC's licensing statistics and provides an update on the implementation of the Manager-In-Charge (MIC) regime. Case studies illustrate some of our areas of focus when assessing the fitness and properness of licensees and applicants.

## Our licensees

The past five years saw significant growth in the population of SFC licensees. The number of licensed corporations (LCs) and individuals increased at annual compound rates of 7% and 3%,

respectively. As of 31 March 2018, the total number of licensees in Hong Kong reached a historical high of 44,238, up 3% from the previous year, while the number of LCs surpassed the 2,700 mark.

Number of licensed corporations and individuals



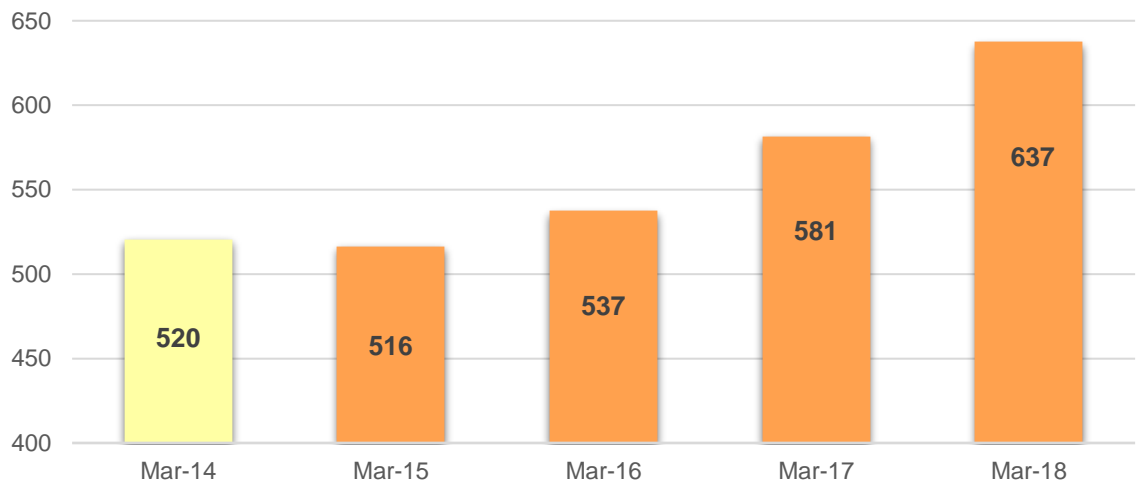


Greater financial market integration between mainland China and Hong Kong is reflected in the increasing number of Mainland entities choosing to establish or extend their financial services businesses in Hong Kong through setting up new LCs or acquiring existing ones. In 2012, the Mainland overtook the United States to become the largest source of shareholder groups controlling LCs. About

13% of all LCs are now controlled by Mainland-based corporate shareholders, as compared to 9% in 2012.

In addition, after the November 2014 launch of Shanghai-Hong Kong Stock Connect, the number of stock exchange participants in Hong Kong has climbed steadily.

**Number of licensed corporations which are stock exchange participants**



Licensing statistics are published on the SFC website:

[www.sfc.hk/web/EN/published-resources/market-and-industry-statistics/statistics-by-topics](http://www.sfc.hk/web/EN/published-resources/market-and-industry-statistics/statistics-by-topics)

## Manager-In-Charge (MIC) regime

The MIC regime was fully implemented in October 2017 to drive better ex ante decisions and proper behaviour at firms. It adds clarity as to which individuals are senior management, heightens awareness of senior management's accountability, regulatory obligations and potential liabilities, better aligns senior management with the existing responsible officer (RO) regime and standardises the format for submitting management structure information to the SFC.

To prepare for compliance with the MIC regime, many firms discussed with the SFC their specific management structures as well as actions to strengthen corporate governance and senior management accountability. We are pleased to share some specific improvements we identified.

- A senior executive assuming a leading position in a global financial group was previously only licensed as a representative, but he supervised a team of ROs who reported directly to him. The financial group rectified this misalignment by appointing him as a board member and an MIC of the relevant LCs. He also obtained our approval to be an RO.
- Another global financial group identified nearly 20 senior executives, who either were previously licensed as representatives or did not hold an SFC licence, to become MICs and ROs of the group's LCs. The group also informed us that they provided MICs with additional training on their obligations as senior management as well as professional indemnity insurance.
- A Mainland financial group with several LCs operating in Hong Kong proactively reviewed and enhanced the management structures of its LCs by appointing a number of group-level senior management personnel as MICs. We approved the applications of the MICs responsible for Overall Management Oversight (OMO), who were previously licensed as representatives, to become ROs.
- A global financial group enhanced the governance structures of its LCs by appointing the group's senior executives as the LCs' board members. It also established new management and operating committees reporting to the LCs' boards to manage the firms' businesses and controls. The responsibilities and accountability of the committees and individual senior managers are now clearly delineated across the organisation.

### ***As a newly appointed chairman of a financial group which operates several LCs, should I be designated as an MIC of OMO of these LCs?***

It depends. You should be an MIC of OMO if you are involved in directing and overseeing the overall operations of an LC on a day-to-day basis. The LC's board of directors is responsible for appointing appropriate senior personnel who have sufficient authority to be MICs.

Please refer to Paragraphs 9 and 10 in our 16 December 2016 circular on senior management accountability:

[www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=16EC68](http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=16EC68).

As of 31 March 2018, about 10,600 individuals were appointed as MICs. Around 90% of the MICs responsible for the OMO or Key Business Line (KBL) function were approved as ROs of their respective principals. So far, the SFC has handled about 2,000<sup>1</sup> RO applications from MICs of OMO or KBL.

All active LCs have made initial MIC submissions to the SFC. They are required to notify the SFC of any changes to their MIC appointments or organisational charts.

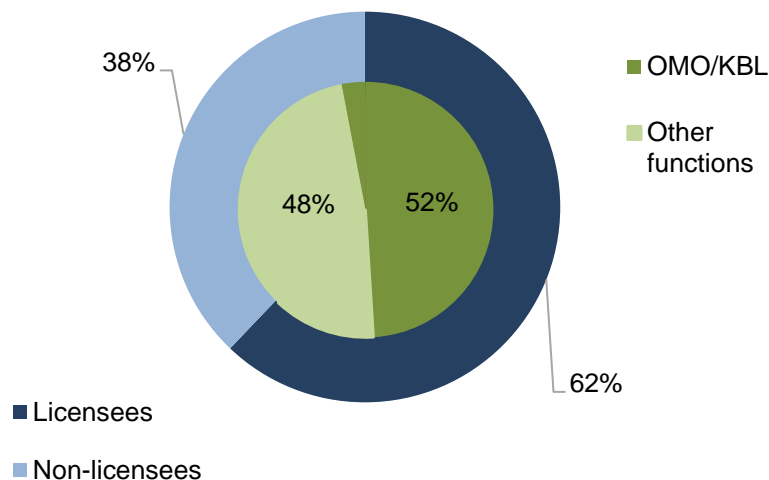
About 40% of all MICs are not licensed persons as they are mainly involved in compliance, control and operational functions. The MIC regime makes it easier for the SFC to keep track of information

about a firm's senior management who are required to comply with conduct requirements under various SFC codes and guidelines<sup>2</sup> regardless of whether they are licensed persons.

In previous instances, the SFC disciplined unlicensed persons involved in the management of LCs<sup>3</sup> for negligence or failure to properly supervise an LC's business.

The SFC will conduct a thematic review of LCs' management structure and effectiveness, including board governance as well as the responsibilities of MICs (based within or outside Hong Kong) and how they discharge them.

**MICs as of 31 March 2018**



<sup>1</sup> Some of these applications are still being processed.

<sup>2</sup> For example, General Principle 9 and Paragraph 14.1 of the Code of Conduct for Persons Licensed by or Registered with the SFC. Please also see MIC-related FAQ #19 on the SFC website: [www.sfc.hk/web/EN/faqs/intermediaries/licensing/manager-in-charge-regime.html](http://www.sfc.hk/web/EN/faqs/intermediaries/licensing/manager-in-charge-regime.html).

<sup>3</sup> In accordance with section 194(7) of the SFO, a regulated person includes a person involved in managing the business of a licensed corporation.

## Case studies

In the following case studies, we highlight our regulatory focus as well as areas of concern which could result in the refusal of licensing applications and, where appropriate, prosecution against the persons concerned.

### **Fitness and properness of substantial shareholders**

Any person who intends to become a substantial shareholder of an LC should seek the SFC's prior approval under section 132(1) of the SFO. The applicant should satisfy the SFC that the LC will remain fit and proper if the application is approved. Failure to do so will lead to refusal of the application.

When considering a substantial shareholder application, the SFC will look into the applicant's background, sources of funding and financial position to assess his fitness and properness, the legitimacy of the funds as well as to confirm that he is the ultimate beneficial owner. We will also assess potential changes to the LC's business plan and senior management following a change in ownership.

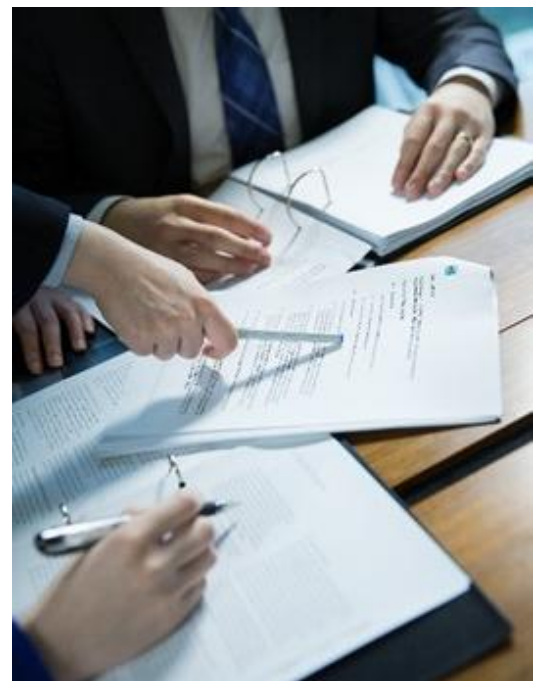
For more information, please refer to our 2 June 2017 circular regarding substantial shareholders and responsible officers: [www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=17EC32](http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=17EC32).

### *Reputation and character*

In one case, an overseas financial group proposed to expand its business to Hong Kong by acquiring an existing LC. Some of the group's affiliates applied for approval to become substantial shareholders of the LC.

As part of our assessment, we conducted regulatory checks and exchanged information about the applicants with local and overseas regulators. Adverse information concerning the group and its ultimate controller was noted during the vetting process. In particular, some group affiliates were disciplined in other jurisdictions while others were put on investor alert lists maintained by other regulators. Worse still, the applicants did not disclose these matters to the SFC.

Having carefully reviewed the information available, we refused the application given the group's notoriety and poor compliance culture, which we considered would tarnish the fitness and properness of the LC it sought to acquire and adversely affect investors' interests and market integrity.





### *Questionable financial position*

In another case, Ms X, a substantial shareholder applicant, had borrowed a significant amount, but she could not satisfactorily demonstrate her repayment ability. Through her wholly-owned company, Ms X obtained a very large loan from a broker by pledging her interests in the shares in a small-cap listed stock (which accounted for over 50% of the issued shares of the listed company) as collateral with an unusually high margin ratio.

When we expressed doubt as to whether Ms X could meet margin calls if the value of the pledged shares dropped significantly, she merely claimed that the broker would not make any margin calls but she could not explain why that would be the case. We refused Ms X's application as we had serious concerns about her financial position and source of funding.

### ***If I have been the subject of an SFC investigation, do I need to disclose this in my licence application?***

Yes, you are required to include information about the SFC's investigation in your application form. You may assume our consent to the disclosure without the need to make a formal application to our Enforcement Division.

For more information on how our Enforcement Division administers the secrecy provisions, please refer to the SFC website:  
[www.sfc.hk/web/EN/regulatory-functions/enforcement/secrecy-provision.html](http://www.sfc.hk/web/EN/regulatory-functions/enforcement/secrecy-provision.html)

### *Significant change of an LC's business*

Mr Y submitted an application to the SFC to acquire a boutique asset management firm and proposed that the firm would launch three unauthorised funds investing in alternative asset classes with an estimated scale of RMB20 billion. The firm's financial returns showed that over a long period of time, it conducted very limited business. More importantly, none of the existing ROs had the necessary experience or skills to implement the intended investment strategies or risk control measures.

We were concerned about the competency of the LC and its ROs to carry out the proposed business activities. We communicated our intention to refuse the application as the LC did not appear to have the required expertise, systems and controls to manage the risks associated with the proposed business. Mr Y subsequently decided not to proceed with the acquisition.

### ***Providing false and misleading information***

Licence applicants should ensure that the information provided in their applications is complete, true and accurate. Under section 383 of the SFO, providing false or misleading information to the SFC may have criminal consequences.

In an application for a representative licence, Ms Z represented that she had no conviction records. However, the Hong Kong Police revealed that she had two convictions for theft.

Ms Z's failure to disclose this information and the nature of the convictions called into question her honesty and hence her fitness and properness to be licensed.

The SFC was minded to refuse the application, which was subsequently withdrawn by Ms Z. She was prosecuted for providing false and misleading information in support of her licence application.

### ***Does an applicant need to separately file a hard copy of the entire licence application pack submitted electronically through the SFC Online Portal?***

With effect from 14 May 2018, all applicants submitting applications online are only required to file a hard copy of the following pages of the application pack to the SFC:

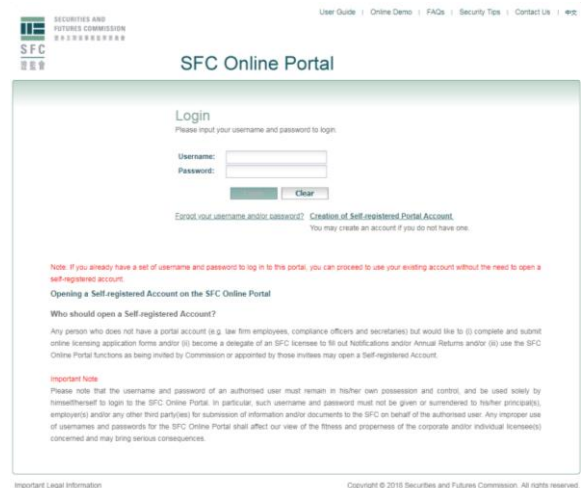
- cover page;
- declaration page(s) duly signed; and
- vetting authorisation form (if necessary) duly signed.

Please refer to [https://portal.sfc.hk/sfcportal/faq/Streamlined\\_flow\\_en.pdf](https://portal.sfc.hk/sfcportal/faq/Streamlined_flow_en.pdf) for more information.

## **Your Licensing Case Officer**

Effective May 2018, the Licensing Department implemented a new team structure.

To contact your Licensing Case Officer, please log into your SFC Online Portal account, and then click "Contact Intermediaries Case Officer" under "Profile".



If you want to receive the *SFC Compliance Bulletin: Intermediaries* by email, simply subscribe at the SFC website by selecting *SFC Compliance Bulletin: Intermediaries* on the designated page.

Securities and Futures Commission  
35/F, Cheung Kong Center  
2 Queen's Road Central  
Hong Kong  
  
(852) 2231 1222  
enquiry@sfc.hk  
www.sfc.hk