



Supervisory Policy Manual

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This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To describe the HKMA's approach to supervising the regulated activities of AIs that are registered, or deemed to be registered, with the SFC under the Securities and Futures Ordinance

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Guideline 13.1 "Supervision of Exempt Dealers" dated 28.12.95;

Circular¹ "SFC's Client Identity Rule" dated 09.03.99;

Circular "Code of Conduct for Persons Registered with the SFC" dated 09.12.99;

Circular "Securities (Margin Financing) (Amendment) Ordinance 2000" dated 01.06.00;

Circular "Electronic Initial Public Offering ("eIPO")" dated 16.08.00;

Circular "Amendments to SFC's Client Identity Rule and Policy" dated 25.07.00;

Circular "The Revised Code of Conduct for Persons Registered with the SFC" dated 16.03.01;

¹ Note that this and the other circulars subsequently listed are those issued by the HKMA. Circulars issued by the SFC mentioned in their titles remain in force until revoked by the SFC.



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Circular “Fit and Proper Criteria for Staff of Authorized Institutions that are Exempt Dealers” dated 21.03.01;

Circular “Amendments to Guidance Note on Competence and Guidance Note on Continuous Professional Training issued by the SFC” dated 13.08.01;

Circular “Circular issued by the SFC regarding compliance with section 79(1) of the Securities Ordinance” dated 16.10.01;

Circular “Circular issued by the SFC regarding Equity-linked Instruments” dated 10.12.01; and

Circular “Marketing of Collective Investment Schemes (CIS)” dated 29.11.02.

Application

To all AIs that are registered, or deemed to be registered, with the SFC under the Securities and Futures Ordinance

Structure

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1. Introduction

1.1 Terminology

- 1.1.1 In this module:



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- “associated entity” has the meaning set out in Schedule 1 of the Securities and Futures Ordinance. In broad terms, an associated entity of a RI refers to a company which is in a controlling entity relationship (as defined in the Securities and Futures Ordinance) with the RI, and receives or holds in Hong Kong client assets of the RI.
- "eIPO" means an initial public offering (of securities) made via the internet or other electronic media;
- "executive officer" has the meaning set out in §2 of the Banking Ordinance. Essentially, an executive officer is an individual appointed by a RI to directly supervise the conduct of one or more regulated activities of that RI. Such officer must have received prior written consent from the MA;
- “intermediary” means a licensed corporation or a registered institution under the Securities and Futures Ordinance;
- “licensed corporation” means a corporation which is granted a licence by the SFC under §116 or §117 of the Securities and Futures Ordinance;
- “misconduct” for the purposes of Part IX of the Securities and Futures Ordinance has the meaning set out in §193 of that Ordinance. It includes a contravention of any relevant provision of the Securities and Futures Ordinance or of any terms and conditions of registration or, in relation to the carrying on of any regulated activity, an act or omission which is or is likely to be prejudicial to the interest of the investing public or to the public interest;
- “misconduct” in relation to a relevant individual and for the purposes of §58A of the Banking Ordinance has the meaning set out in §58A(6) of that Ordinance. This generally refers to a contravention of any



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relevant provision of the Securities and Futures Ordinance or, in relation to the carrying on of any regulated activity, an act or omission which is or is likely to be prejudicial to the interest of the investing public or to the public interest;

- “misconduct” in relation to an executive officer and for the purposes of §71C of the Banking Ordinance has the meaning set out in §71C(12) of that Ordinance. It includes a contravention of any relevant provision of the Securities and Futures Ordinance or of any condition attached to the consent or provisional consent granted by the MA or, in relation to the carrying on of any regulated activity, an act or omission which, in the opinion of the MA, is or is likely to be prejudicial to the interest of the investing public or to the public interest;
- "recognized stock market" has the meaning set out in Schedule 1 of the Securities and Futures Ordinance;
- "regulated function" in relation to a regulated activity has the meaning set out in §20(10) of the Banking Ordinance. It basically refers to any function performed for or on behalf of or by an arrangement with a RI relating to the regulated activity, other than work ordinarily performed by an accountant, clerk or cashier;
- “related corporation” has the meaning set out in Schedule 1 of the Securities and Futures Ordinance;
- "relevant individual" has the meaning set out in §20(10) of the Banking Ordinance. In generic terms, a relevant individual is an individual who carries out any regulated function in one or more regulated activities of a RI. An executive officer is therefore a relevant individual;
- "RI" means an AI that is a registered institution under the Securities and Futures Ordinance;



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- "securities" has the meaning set out in Schedule 1 of the Securities and Futures Ordinance;
- "SFC" means the Securities and Futures Commission; and
- "SFC Code" means the Code of Conduct for Persons Licensed by or Registered with the SFC, issued and updated by the SFC from time to time.

1.1.2 The explanations of legal terms given above and the summaries of legal and regulatory requirements provided in the remainder of this module are for readers' reference and guidance only. Legal advice should be sought where precise interpretation is required.

1.2 Registration with the SFC and scope of regulated activities

1.2.1 Under §119 of the Securities and Futures Ordinance, the SFC may, upon application by an AI, register the applicant for carrying on one or more regulated activities (other than Type 3 and Type 8) specified by the SFC.

1.2.2 The regulated activities are :

- Type 1: dealing in securities;
- Type 2: dealing in futures contracts;
- Type 3: leveraged foreign exchange trading;
- Type 4: advising on securities;
- Type 5: advising on futures contracts;
- Type 6: advising on corporate finance;
- Type 7: providing automated trading services;
- Type 8: securities margin financing; and
- Type 9: asset management.

For definitions of each of the regulated activities, refer to Schedule 5 of the Securities and Futures Ordinance.



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- 1.2.3 AIs do not require registration with the SFC to engage in leveraged foreign exchange trading and securities margin financing.
- 1.2.4 To apply for registration, an AI needs to complete the specified forms and submit them, together with the required supporting documents, to the SFC². The key information to be supplied for the purpose of such application includes details on:
- share capital, corporate structure and substantial shareholders;
 - proposed regulated activities, including business plan, expected contribution to gross operating income, organisational structure, operational flowcharts, internal control procedures, methods to address and control conflicts of interest, as well as a sample of the client agreement;
 - proposed associated entities; and
 - proposed executive officers.
- 1.2.5 An AI also needs to appoint at least two executive officers to directly supervise each regulated activity that is the subject of its registration. The executive officers must obtain the MA's written consent and applications should be submitted directly to the HKMA.
- 1.2.6 To facilitate planning (and allocation of resources if necessary), all deemed RIs should confirm with the HKMA the date of their submission of application to become RIs at least 4 months before they lodge the application with the SFC. For other AIs (i.e. not being deemed RIs) it is also desirable that they notify the HKMA of their intended application in advance.

² There is a separate set of application forms for "deemed RIs" (see subsection 1.3 for definition), which requires less information. Refer to para. 1.3.9 for more details.



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- 1.2.7 In deciding whether to register or refuse to register an AI, the SFC will refer the application to the MA, will have regard to any advice given by the MA and may rely wholly or partly on that advice in making its decision.
- 1.2.8 In advising the SFC whether he is satisfied that the applicant is fit and proper to be registered for the regulated activities concerned, the MA will take into account the factors set out in §129 of the Securities and Futures Ordinance. The HKMA will also make reference to any relevant rules, codes, guidelines or guidance issued by the SFC. In practice, the HKMA will evaluate the application taking into account matters such as the AI's previous experience in the activities, management capabilities, controls and resources.

1.3 Transitional arrangements

- 1.3.1 As stipulated in Schedule 10 of the Securities and Futures Ordinance, there is a transitional period of two years from the commencement of the Ordinance for some categories of AIs as specified in paras. 1.3.2 to 1.3.4 below (collectively "deemed RIs") to apply for registration with the SFC.
- 1.3.2 An AI which immediately before the commencement of the Securities and Futures Ordinance was an **exempt dealer** under the repealed Securities Ordinance is deemed to have been registered with the SFC for Type 1, Type 4, Type 6 and (subject to the condition of not providing a service of managing a portfolio of futures contracts for another person) Type 9 regulated activities during the transitional period.
- 1.3.3 Where an AI falling under para. 1.3.2 above carried on a business of providing automated trading services (e.g. providing to investors or other market participants an electronic trading system for securities or futures contracts, which includes dealing through the internet) immediately before the commencement of the Securities and Futures Ordinance, it is deemed to have been registered for Type 7 regulated activity as well.



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- 1.3.4 An AI which immediately before the commencement of the Securities and Futures Ordinance was **either a licensed bank that engaged in investment advisory activities or an exempt investment adviser** under the repealed Securities Ordinance is deemed to have been registered with the SFC for Type 4, Type 6 and (subject to the condition of not providing a service of managing a portfolio of futures contracts for another person) Type 9 regulated activities during the transitional period.
- 1.3.5 Where immediately before the commencement of the transitional period, an individual was engaged by a deemed RI to perform any act which would constitute a regulated function in relation to a regulated activity, that individual is regarded as a relevant individual (a “deemed relevant individual”) in respect of that regulated activity and his name is deemed to have been entered in the HKMA Register³ during the transitional period. Notwithstanding this transitional provision in the Securities and Futures Ordinance, the names of all deemed relevant individuals will be included in the HKMA Register, with clear indication that they are “registered under transitional arrangements”, immediately upon the commencement of the Banking (Amendment) Ordinance 2002.
- 1.3.6 Deemed RIs need not appoint executive officers during the transitional period. They should however identify well in advance the individuals who will fulfil such role. They should also submit their proposals for executive officer appointments for the MA’s consent not later than their application to the SFC for registration.
- 1.3.7 The relevant provisions in the Securities and Futures Ordinance as well as the SFC rules, codes and guidelines are generally applicable to the deemed RIs and their relevant individuals upon the start of the transitional period.

³ This refers to the register established and maintained by the MA under §20(1)(ea) of the Banking Ordinance.



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- 1.3.8 If a deemed RI intends to continue the conduct of any regulated activity after the transitional period, it must apply to the SFC for registration and seek the MA's consent for the executive officers to be appointed.
- 1.3.9 When a deemed RI applies to the SFC for registration, it will be asked to indicate in a simplified application form the types of regulated activities it applies to carry on and the names of its proposed executive officers. Where the deemed RI applies to carry on a new regulated activity, it will be required to provide additional information in relation to its business plan, internal control procedures etc.
- 1.3.10 For more details of the transitional arrangements, refer to Schedule 10 of the Securities and Futures Ordinance and the Guidelines on Transitional Arrangements issued by the SFC.

1.4 Memorandum of Understanding

- 1.4.1 While the ultimate responsibility for the regulation of intermediaries in the securities market rests with the SFC, the HKMA will remain the front line supervisor for RIs and is responsible for the day-to-day supervision of the regulated activities of RIs. This arrangement is underpinned by a MoU between the HKMA and the SFC in respect of the securities supervisory regime. The MoU has been posted on the public website of the HKMA.
- 1.4.2 Under §120 of the Banking Ordinance the MA has the right to exchange information about the regulated activities of RIs with the SFC. Issues of supervisory concern involving the regulated activities of RIs are also discussed in the regular meetings between the two regulators under the MoU. Complaints received by the SFC involving RIs are forwarded to the HKMA for follow up by either the Complaint Handling Teams of the HKMA or specialised examination teams (see subsection 2.2 below) during on-site examinations.

 HONG KONG MONETARY AUTHORITY 香港金融管理局		
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2. Supervisory approach

2.1 General

2.1.1 The general approach adopted by the HKMA is to require RIs to comply with standards equivalent to those applied by the SFC to licensed corporations in their regulated activities.

2.2 On-site examinations

2.2.1 The HKMA conducts special on-site examinations of the regulated activities of RIs. Dedicated examination teams have been set up for this purpose. The focus of examination is mainly on regulatory compliance, internal controls and management supervision.

2.2.2 The objectives of the examinations are to enable the HKMA to understand the way in which regulated activities of the relevant RI are being conducted and to determine whether it has established appropriate and effective policies, procedures and controls to ensure compliance with the relevant legislation, rules, codes and guidelines issued by the SFC. RIs should be able to demonstrate that the relevant practices and procedures are well established and effectively applied.

2.2.3 The HKMA monitors the quality and competence of relevant individuals in its on-site examinations, taking into account the relevant provisions in the SFC's Fit and Proper Guidelines, Guidelines on Competence and Guidelines on Continuous Professional Training (see subsection 4.2 below).

2.2.4 While the general power to conduct examination of AIs comes from §55 of the Banking Ordinance, the MA also has a specific power under §180 of the Securities and Futures Ordinance in respect of the inspection of RIs, their associated entities and related corporations. Refer to para. 3.2.3 below for more details.



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2.3 Off-site reviews

- 2.3.1 To facilitate the continuing supervision of the regulated activities of RIs, the HKMA requires all RIs (including deemed RIs) to submit semi-annually the information specified in the “Return of Securities Related Activities – MA(BS)14”.
- 2.3.2 The return is designed to provide the HKMA with a general overview of the regulated activities being carried out by each RI as well as the trends in the industry. Information collected will also be used for determining the scope and focus of on-site examinations.

2.4 Guidelines and supervisory standards

- 2.4.1 A summary of the major legal and regulatory requirements is given in sections 3 and 4 below. RIs are also required to notify the HKMA of certain events as prescribed in section 5 below. RIs are expected to have internal control systems to ensure compliance with these requirements. The HKMA will monitor compliance primarily through on-site examinations.
- 2.4.2 The SFC has the power under Parts VI and VII of the Securities and Futures Ordinance to issue, from time to time, rules on specific aspects of regulated activities and codes and guidelines in relation to the carrying on of regulated activities. These rules, codes or guidelines, etc. are applicable to RIs insofar as the latter’s regulated activities are concerned.
- 2.4.3 The HKMA circulars “Subsidiary legislation under the Securities and Futures Ordinance (SFO)” and “Commencement of the Banking (Amendment) Ordinance 2002 and the Securities and Futures Ordinance (SFO)” issued on 18.11.02 and 20.12.02 respectively contain the lists of SFC rules, codes, guidelines and circulars applicable to RIs in respect of the conduct of regulated activities. RIs will receive reminders when the SFC issues new or amended legal / regulatory requirements.



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- 2.4.4 In interpreting the regulatory requirements of the SFC, the HKMA will consult the SFC where appropriate and draw reference from the latter's experience in applying the requirements to licensed persons.
- 2.4.5 The MA may also issue guidelines or guidance notes to RIs on the application of the Securities and Futures Ordinance, as well as the rules, guidelines and business conduct codes issued by the SFC, to the conduct of regulated activities by RIs.
- 2.4.6 The HKMA will take into account a RI's compliance with the applicable legal and regulatory requirements in considering whether that AI satisfies the continuing authorization criterion in respect of adequate systems of internal control under para. 10 of the Seventh Schedule to the Banking Ordinance.

3. Legal requirements

3.1 The Banking Ordinance

Relevant individuals

- 3.1.1 Under §20(3) of the Banking Ordinance, every RI is required to submit specified particulars of its relevant individuals to the MA for the inclusion of such individuals' particulars in the HKMA Register. In accordance with §20(4B) of the Banking Ordinance, such particulars are available for public inspection in the form of an on-line record on the HKMA public website.
- 3.1.2 A relevant individual does not have to be an employee of the RI. For example, the individual can be an employee of the RI's parent or group company that supports the conduct of a regulated activity of the RI.
- 3.1.3 In order to facilitate the establishment of the HKMA Register upon the commencement of the Banking (Amendment) Ordinance 2002, all deemed RIs have been required to submit, by means of a spreadsheet, the particulars of their



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deemed relevant individuals as at 28.02.03, and any subsequent change (addition, deletion, modification of details etc) in such particulars by an on-line submission mechanism. For all RIs, the reporting of the specified particulars of their non-deemed relevant individuals, including any subsequent change, will be effected by the same on-line submission mechanism⁴. Both the spreadsheet and the on-line mechanism use the STET system. For more details of the submission of information on relevant individuals, refer to the HKMA circulars “Register of relevant individuals to be maintained by the HKMA under the Banking (Amendment) Ordinance 2002” issued on 12.09.02, “Commencement of the Banking (Amendment) Ordinance 2002 and the Securities and Futures Ordinance (SFO)” issued on 20.12.02 and “New securities supervisory regime -- Register to be maintained by the HKMA and Specific guidance in relation to relevant individuals” issued on 27.02.03.

- 3.1.4 Pursuant to §20(4) of the Banking Ordinance, RIs should give notice to the MA of any subsequent change in the information submitted for the purpose of the register. Such notification has to be made to the MA within 7 business days of the change.
- 3.1.5 Only those individuals whose names are entered (as deemed relevant individuals or otherwise) in the HKMA Register may engage in any regulated function of any regulated activity of a RI⁵. RIs should therefore submit the names and particulars of individuals for inclusion in the HKMA Register prior to such individuals engaging in such capacity.

⁴ All changes relating to executive officers however should be notified to the HKMA by submissions in writing.

⁵ Although by definition deemed relevant individuals are deemed to have their names entered in the HKMA Register, the latter actually shows their particulars as well with indication of their “deemed status”, i.e. “registered under transitional arrangements”.



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3.1.6 RIs are expected to establish and maintain a database of the names and particulars of relevant individuals in order to facilitate reporting to the HKMA. To be in line with the information requirements for licensed representatives under the Securities and Futures (Licensing and Registration)(Information) Rules, such database should also include the following information or records, with supporting evidence for (d) and (e), for each relevant individual:

- (a) residential address;
- (b) correspondence address, if different from (a);
- (c) contact telephone number;
- (d) details of any registration or authorization (however described) to carry on a regulated activity by the SFC or a regulatory organisation or authority outside Hong Kong⁶;
- (e) any membership (however described) of a stock exchange or futures exchange in Hong Kong or elsewhere;
- (f) the types of services provided by the individual in relation to the conduct of regulated activities on behalf of the RI (which may be in the form of job description); and
- (g) any current directorship, partnership or proprietorship and the dates of appointment, or commencement, of any such directorship, partnership or proprietorship (as the case may be).

3.1.7 **It is a statutory condition of registration for a RI to ensure that its relevant individuals are fit and proper to be so engaged.** In determining whether an individual is and remains fit and proper to be a relevant individual, RIs should ensure that the individual concerned meets the Fit and Proper Guidelines, the Guidelines on Competence and

⁶ RIs should check whether the individual is permitted to take employment in Hong Kong.



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the Guidelines on Continuous Professional Training issued by the SFC. Refer to subsection 4.2 below for specific guidance.

- 3.1.8 The HKMA will not assess the fitness and propriety of relevant individuals prior to placing their names on the register. As noted in para. 3.1.7 above, this responsibility rests with the RI concerned. The HKMA will however conduct background checks on the relevant individuals with the SFC and, if necessary, other relevant (e.g. supervisory, law enforcement) agencies. RIs should inform all their relevant individuals that their personal information may be forwarded by the HKMA to other bodies for such purpose. The HKMA will treat all data about the individuals concerned in accordance with the Personal Data (Privacy) Ordinance. Any disclosure of such data to other persons will be in accordance with §§120 and 121 of the Banking Ordinance.

Executive officers

- 3.1.9 Under §§71C and 71D of the Banking Ordinance every RI shall appoint **not less than two executive officers to be responsible for directly supervising the conduct of each regulated activity**. The same executive officers can be appointed for more than one regulated activity. They should be fit and proper, vested with sufficient authority and have received the consent of the MA. As executive officers are relevant individuals, their particulars also have to be entered in the HKMA Register.
- 3.1.10 Where a person has become or continues to be an executive officer of an AI in contravention of §71C, it is a ground for revocation of the AI's authorization under para. 15A of the Eighth Schedule to the Banking Ordinance.
- 3.1.11 In considering whether to grant consent to persons applying to become executive officers, the MA will take into account the factors set out in §129 of the Securities and Futures Ordinance and the requirements stipulated by the SFC in the Fit and Proper Guidelines and the Guidelines on



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Competence. Refer to subsection 4.2 below for specific guidance.

- 3.1.12 As a general guideline, if any of the individuals directly responsible for supervising the conduct of a regulated activity is the Chief Executive, an Alternate Chief Executive, or a Director of a RI, the HKMA would expect such person to be appointed as an executive officer. Where such appointments result in less than two executive officers for any regulated activity, the appointment of the remaining executive officer(s) should be based upon seniority. In other words, the executive officers for each regulated activity should be the relevant individuals in the highest rank according to the RI's internal ranking.
- 3.1.13 Notwithstanding these general guidelines, the MA must be satisfied, among other things, that the appointed executive officers are vested with sufficient authority within the RI for such purpose. The HKMA will take into account the size of the RI, the significance of the regulated activity in relation to the overall business of the institution, the management structure as well as the reporting line of the executive officers.
- 3.1.14 Where a person applies to become an executive officer for more than one regulated activity, the MA is unlikely to give consent in respect of all such regulated activities if there is potential conflict of interest. This may arise if, say, Type 6 and Type 9 regulated activities are supervised by the same individual at the same time. A possible exception is where the proposed executive officer comes from the very top level of management overseeing a substantial part of the AI's operations, e.g. the Chief Executive, an Alternate Chief Executive, or a Director.
- 3.1.15 It is a statutory condition of registration under Part V of the Securities and Futures Ordinance that, in relation to each regulated activity, there is **at least one executive officer available at all times** to supervise the business of that activity. To facilitate compliance with this condition, the MA



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may, upon request of a person seeking consent under §71C(1) of the Banking Ordinance to be an executive officer, give provisional consent to the person to be such executive officer. The formal consent will be given when the HKMA has satisfactorily completed the vetting procedures in respect of the person. The procedures will be similar to those conducted by the HKMA in respect of applicants to become a Director or the Chief Executive of an AI.

- 3.1.16 RIs should note that it is a minimum authorization criterion under para. 4 of the Seventh Schedule to the Banking Ordinance for the MA to be satisfied that an AI has adequate systems of control to ensure that each person who is, or is to be, an executive officer is fit and proper to hold that particular position.

Removal of relevant individuals (including executive officers) from their roles

- 3.1.17 Where a RI forms the view that a relevant individual is no longer fit and proper to be engaged in the conduct of any regulated activity, it should promptly notify the HKMA to remove the individual's name from the HKMA Register.

3.1.18 Where

- a relevant individual is, or was at any time, guilty of misconduct; or
- the MA is of the opinion that a relevant individual is not, or has ceased to be, a fit and proper person in his capacity as that type of relevant individual,

the MA may, after consultation with the SFC, exercise his power under §58A of the Banking Ordinance to remove or suspend the name of the relevant individual concerned from the HKMA Register.

3.1.19 Where

- an executive officer is, or was at any time, guilty of misconduct; or



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- the MA has ceased to be satisfied that an executive officer is a fit and proper person to be such type of officer or has sufficient authority within the RI concerned to be such officer,

the MA may, after consultation with the SFC, exercise his power under §71C of the Banking Ordinance to withdraw or suspend his consent.

3.1.20 In addition, the MA may make recommendations to the SFC regarding the exercise of the latter's powers under the Securities and Futures Ordinance to impose other disciplinary measures on the relevant individuals (including executive officers) concerned. Refer to section 6 below for more details.

3.2 The Securities and Futures Ordinance

3.2.1 In general, RIs are subject to the provisions of the Securities and Futures Ordinance in the same way as licensed corporations in respect of their regulated activities. The major areas of difference, which arise from the need to avoid regulatory overlap, are:

- capital requirements – RIs are not subject to the Securities and Futures (Financial Resources) Rules; and
- handling of client money – RIs are not subject to the Securities and Futures (Client Money) Rules.

3.2.2 In particular, RIs and their relevant individuals are governed by the following statutory requirements in the conduct of regulated activities:

- rules made by the SFC under Part VI of the Securities and Futures Ordinance, which are also



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applicable to the associated entities⁷ of intermediaries, regarding -

- handling of client securities, i.e. the Securities and Futures (Client Securities) Rules;
 - keeping of accounts and records relating to their regulated activities, i.e. the Securities and Futures (Keeping of Records) Rules; and
 - provision of contract notes, receipts, statements of account and notifications, i.e. the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules; and
- Part VII of the Securities and Futures Ordinance -
 - rules and codes for business conduct in relation to regulated activities which are made by the SFC under §§168 and 169 respectively;
 - rules on the requirements for options trading made by the SFC under §173;
 - restrictions on short selling (§§170, 171 and 172);
 - restrictions on unsolicited calls (§174) ; and
 - prohibition on certain representations (§176).

Refer to the HKMA circular “Calls in Relation to Securities or Futures Products and Services” dated 13.01.03 for specific guidance on the restrictions on unsolicited calls.

3.2.3 Further, under Part VIII, §180 of the Securities and Futures Ordinance, the MA as the relevant authority can authorize a person in writing to:

⁷ All associated entities of intermediaries are subject to the Securities and Futures (Associated Entities -- Notice) Rules in addition to the three rules mentioned below. Those associated entities that are not AIs are also subject to the Securities and Futures (Accounts and Audit) Rules.



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- (a) enter the premises of a RI or its associated entity;
- (b) inspect and make copies of records and documents relating to:
 - the business, or any transaction or activity undertaken in the course of (or which may affect) the business, conducted by the RI or the associated entity, or
 - any transaction carried out by a related corporation of the RI or the associated entity; and
- (c) make inquiries of the RI or the associated entity (or a related corporation of the RI or the associated entity) concerning:
 - any record or document referred to in (b), or
 - any transaction or activity undertaken in the course of, or which may affect, the business conducted by the RI or the associated entity.

The purpose is to ascertain whether a RI or its associated entity complies with the applicable requirements in §180(2) of the Securities and Futures Ordinance.

3.2.4 While the SFC relies on the HKMA for the day-to-day supervision of the regulated activities of RIs, it may commission an investigation of matters relating to a RI under §182 of the Securities and Futures Ordinance, where it:

- has reasonable cause to believe that:
 - (a) an offence under any of the relevant provisions (as defined in Schedule 1 of the Securities and Futures Ordinance) may have been committed;
 - (b) a person may have engaged in defalcation, fraud, misfeasance or other misconduct in connection with –
 - (i) dealing in any securities or futures contract;



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- (ii) the management of investment in any securities or futures contract;
 - (iii) offering or making any collective investment scheme; or
 - (iv) giving advice in relation to the allotment of securities, or the acquisition or disposal of, or investment in, any securities, futures contract, or an interest in any securities, futures contract or collective investment scheme;
- (c) market misconduct may have taken place; or
- (d) a person's conduct of any of the activities referred to in (b)(i) to (iv) is not in the interest of the investing public or in the public interest;
- has reason to inquire whether any RI or relevant individual is guilty of misconduct, or is not fit and proper to engage in regulated activities;
 - has reason to inquire whether any condition under §104 or §105 is being complied with; or
 - decides to provide assistance to regulators outside Hong Kong under §186 in respect of the above matters.

Pursuant to §182(4) the SFC shall undertake prior consultation with the MA in respect of any investigation to inquire whether any RI or relevant individual is guilty of misconduct, or is not fit and proper to engage in regulated activities.

3.3 Major rules under the Securities and Futures Ordinance that are applicable to RIs

3.3.1 This subsection provides a brief description of the general requirements of three major rules under the Securities and Futures Ordinance that are applicable to RIs. To achieve compliance, RIs should study the relevant rules in detail and



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seek legal advice on the precise interpretation where necessary.

Securities and Futures (Client Securities) Rules

3.3.2 These rules prescribe the manner in which RIs must treat and deal with client securities and securities collateral received or held in Hong Kong in the course of the conduct of a regulated activity.

3.3.3 RIs have to ensure that client securities are deposited in safe custody in segregated accounts designated as trust accounts or client accounts, or registered in the name of the relevant clients or the relevant RI's associated entities. Client collateral may be registered or deposited in accounts in the name of the relevant RI.

3.3.4 RIs and their associated entities are required to take reasonable steps to ensure that client securities and securities collateral are not deposited, transferred, lent, pledged, repledged or otherwise dealt with except in the manner specified in the rules. While this principle has been adopted from the previous regime, the rules have introduced more elaborate and specific provisions. Als should therefore evaluate their legal documents and control procedures in relation to:

- the conduct of regulated activities in order to achieve compliance with the rules; and
- the exposures to other intermediaries that are secured by client securities and/or securities collateral of such intermediaries in order to ensure the validity and enforceability of the Als' rights over the pledged securities.

3.3.5 The SFC has issued a guideline "Suggested Control Techniques and Procedures for Enhancing a Firm's Ability to Comply with the Securities and Futures (Client Securities) Rules and the Securities and Futures (Client Money) Rules". RIs should adopt those suggested controls relevant to compliance with the Securities and Futures (Client



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Securities) Rules. It should be noted that according to the guideline, a RI should keep proper records of all client complaints in relation to the client securities and securities collateral received or held by it in the course of regulated activities, and the details of follow up actions on such complaints.

Securities and Futures (Keeping of Records) Rules

3.3.6 The rules provide for RIs to keep specified records in relation to regulated activities. Except for records showing the particulars of all orders or instructions concerning securities or futures contracts that a RI receives or initiates (as referred to in §1(d) of the schedule to the rules and which have to be retained for at least 2 years), or otherwise provided in the Securities and Futures Ordinance (including any subsidiary legislation made under it), all specified records are required to be retained for at least 7 years.

Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules

3.3.7 A RI that enters into a relevant contract⁸ with or on behalf of a client must prepare and provide a contract note, containing the required information, to the client no later than the end of the second business day after entering into such contract.

3.3.8 Where a RI enters into margined transactions⁹ with or on behalf of a client, it must prepare and provide a daily statement of account, containing the required information, to the client.

⁸ “relevant contract” has the meaning assigned in the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules. It essentially refers to a contract entered into in Hong Kong with or on behalf of a client in the conduct of any regulated activity that is a contract for a dealing in securities or a dealing in futures contracts.

⁹ “margined transaction” has the meaning assigned in the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules. It essentially refers to a relevant contract which requires a client to pay a margin to the RI or provide security to the RI to meet the client’s obligations, other than under an arrangement for the provision of financial accommodation. One typical example is a transaction in a futures contract (as defined in Schedule 1 to the SFO).



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- 3.3.9 Every RI must prepare and provide a statement of account, containing the required information, to a client no later than the end of the seventh business day after the end of the monthly accounting period (which shall be not less than 4 weeks and not exceed 1 month).
- 3.3.10 Where a RI receives any client assets, or security provided in relation to a margined transaction, it must prepare and provide a receipt, containing the required information, to the client no later than the end of the second business day after receiving such assets or security.
- 3.3.11 Upon request from a client, every RI must provide copies of contract notes, statements of account or receipts as soon as practicable. Every RI has a duty to provide, at the request of a client, a statement of account as of the date of request to the client as soon as practicable.

4. Major regulatory requirements

4.1 General

- 4.1.1 The HKMA requires RIs to comply with all relevant legislation, rules and regulations and to conduct their regulated activities in a responsible, honest and business-like manner. Senior management should ensure that policies, procedures and controls are in place for such purposes. Failure of any RI or relevant individuals to observe and abide by any applicable legal and regulatory requirement will call into question their fitness and propriety for the conduct of regulated activities, and may lead to disciplinary action.
- 4.1.2 A general description of the primary documents setting out the main regulatory requirements applicable to the regulated activities of RIs and their relevant individuals is given in the following subsections. RIs and their relevant individuals (whether deemed or not) should refer to these documents for detailed requirements and ensure adherence to them. They are also advised to regularly visit the SFC's website



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for its electronic Regulatory Handbook at <http://www.hksfc.org.hk/eng/bills/html/index/index2.html> for updates and Frequently Asked Questions posted by the SFC on its regulatory requirements.

- 4.1.3 For the sake of investor education, RIs are encouraged to distribute the SFC's investor education leaflets to customers and refer their customers to the SFC-operated Electronic Investor Resources Centre at www.hkeirc.org for further information where appropriate.

4.2 Fit and Proper Guidelines, Guidelines on Competence and Guidelines on Continuous Professional Training

- 4.2.1 The Fit and Proper Guidelines describe the standards that the HKMA and the SFC apply when considering whether an AI is and remains fit and proper for registration. They also specify the standards for assessing the fitness and propriety of relevant individuals (including executive officers) to carry out regulated activities. These encompass areas such as financial status, educational and other qualifications or experience, ability to perform regulated functions efficiently, honestly and fairly, as well as reputation, character, financial integrity and reliability.
- 4.2.2 The HKMA requires all executive officers to meet the fit and proper guidelines applicable to responsible officers of licensed corporations. All other relevant individuals of RIs should satisfy the guidelines for licensed representatives. As noted in para. 3.1.7 above, the obligation is on the RI to ensure that its relevant individuals are fit and proper.

Competence

- 4.2.3 Competence is one of the key elements in the fit and proper test. For a RI, competence is considered by reference to the institution's organisational structure and the combined competence of its personnel. One important factor is the policies and procedures on "Chinese Walls" to address potential conflicts of interest arising from carrying on more than one type of regulated activities (e.g. Type 6 and Type



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9) concurrently. As a general guideline, RIs should not engage an individual in the conduct of multiple regulated activities concurrently if there is potential conflict of interest. This may arise if, say, Type 6 and Type 9 regulated activities are conducted by the same individual at the same time.

4.2.4 RIs should ensure that all relevant individuals (other than the group described in paras. 4.2.5 to 4.2.7 below) meet the initial competence requirements set out in the Guidelines on Competence. This means, among other things,

- acquiring a recognised industry qualification, or possessing a degree in a designated field¹⁰; and
- passing a local regulatory framework paper, unless the individual and the RI meet the exemption criteria relating to experience, scope of activities, regulatory support from other personnel, internal control etc as stipulated in the SFC Guidelines on Competence¹¹.

4.2.5 Individuals who have been directly supervising the conduct of any regulated activity/ies immediately before the commencement of the Securities and Futures Ordinance will be exempt from the initial competence requirements if the individual concerned becomes an **executive officer** in respect of the particular regulated activity/ies within 3 years after the commencement of the Securities and Futures Ordinance (with consent granted by the MA). This treatment is consistent with that applied by the SFC to the potential responsible officers of deemed licensed corporations.

¹⁰ This refers to a degree in Accounting, Business Administration, Economics, Finance or Law, or a degree in another field but with passes in at least 2 courses in the designated fields, or an internationally recognised professional qualification in Law, Accounting or Finance.

¹¹ In this case, the individual should also complete an additional 5 hours of continuous professional training on local regulatory knowledge in the relevant regulated activity on a one-off basis, either within the preceding 6 months or within 12 months after the exemption.



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4.2.6 In addition, the following persons will be considered to have met the initial competence requirements for relevant individuals (**other than executive officers**):

- Individuals who were, as of 31 March 2001¹², engaged by AIs that were exempt dealers under the repealed Securities Ordinance in securities dealing will be considered to have met the initial competence requirements for Type 1, Type 4, Type 6 and Type 9 regulated activities. As indicated in the superseded HKMA circular “Fit and Proper Criteria for Staff of Authorized Institutions that are Exempt Dealers” of 21 March 2001, these individuals are eligible to be “grandfathered” for the purpose of the SFC revised initial competence requirements which took effect on 1 April 2001. The treatment is consistent with that applied by the SFC to licensed representatives.
- Individuals who were, immediately before the commencement of the Securities and Futures Ordinance, engaged by:
 - licensed banks; or
 - AIs that were exempt investment advisers under the repealed Securities Ordinance,in the performance of any function that would constitute a regulated function of Type 4, Type 6 or Type 9 regulated activity will be considered to have met the initial competence requirements for that particular activity if such individuals’ names are entered in the HKMA Register within 3 years after the commencement of the Securities and Futures Ordinance. This treatment is consistent with that applied by the SFC to the deemed licensed representatives of deemed licensed corporations.

¹² These include those individuals who performed securities dealing functions on behalf of such AIs for at least a consecutive period of 12 months in the 3 years preceding 31 March 2001.



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- 4.2.7 As indicated in paras. 4.2.5 and 4.2.6 above, the SFC has adopted similar “grandfather” arrangements. Therefore, an individual considered by the SFC to have met the initial competence requirements for the purpose of becoming a licensed representative in relation to a particular regulated activity will also be considered by the HKMA to have met the initial competence requirements to be a relevant individual in relation to the same regulated activity.
- 4.2.8 For those individuals who benefit from the “grandfather” arrangements described in paras. 4.2.5 to 4.2.7 above in relation to the initial competence requirements, RIs should nevertheless ensure they have met all other requirements under the SFC Fit and Proper Guidelines before engaging them in any regulated activity.
- 4.2.9 There are some other important points to note in relation to initial competence examinations:
- Subject to the “grandfather” arrangements mentioned above, RIs are required to ensure that an individual has passed the relevant industry and local regulatory framework papers before he can be engaged as a relevant individual.
 - Recognised industry qualification and local regulatory framework paper examinations should be completed not more than 3 years prior to the date of engaging in a regulated function of any regulated activity, unless the individual has remained in the industry (either in Hong Kong or overseas) or can prove recent registration with a relevant overseas regulator.
 - Those individuals falling under paras. 4.2.5 to 4.2.7 above will need to meet the relevant requirements on qualifications and examinations if, after taking advantage of the “grandfather” arrangements, they have ceased to engage in the performance of any regulated function of a particular regulated activity by any RI or licensed corporation for a consecutive period of 3 years or more. By the same token, an



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individual who has been “grandfathered” will not be required to meet the initial competence requirements again upon change of employment – unless of course there is a gap of 3 years or more between the employments.

- Different regulated activities may require a pass in different papers of the recognised industry qualifications and the local regulatory framework papers. For details of the competence examination papers, refer to the Guidelines on Competence.

4.2.10 In line with the SFC’s treatment of licensed representatives, the HKMA will allow a six-month grace period for a relevant individual who has yet to pass the local regulatory framework paper but has otherwise satisfied the initial competence test. In respect of these individuals, the relevant RI is responsible for:

- ensuring such individuals have met all other requirements under the SFC Fit and Proper Guidelines;
- keeping proper records indicating that such individuals are subject to the six-month grace period; and
- ensuring that the aforesaid records are under regular and independent review (which may be performed by internal audit or compliance personnel) and that prompt action is taken to remove an individual from the HKMA Register if that individual cannot obtain a pass in the local regulatory framework paper by the end of the six-month grace period.

4.2.11 If an individual applies to be an executive officer for Type 6 regulated activity and intends to give advice on matters falling within the ambit of the Codes on Takeovers and Mergers and Share Repurchases (“codes-related matters”), he must satisfy the HKMA that he has sufficient experience in this area. For this purpose, the HKMA will take into



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account the views of the SFC. If the applicant cannot satisfy the HKMA that he has sufficient experience in this area, the MA's consent will be subject to the condition that the applicant cannot act as a sole executive officer of the RI in relation to codes-related matters. In such case, the RI must appoint at least one other executive officer (who is not subject to this condition) to directly supervise the conduct of advising on any codes-related matters.

Temporary engagement

4.2.12 In line with the SFC's granting of temporary licences for representatives under the Securities and Futures Ordinance, a RI may temporarily engage an individual in the conduct of a regulated function of one or more regulated activities (other than Type 7 and Type 9) provided that:

- the engagement is for a period not exceeding 3 months;
- such engagements of the same individual should not in total exceed 6 months in any period of 24 months;
- such individual carries on the relevant activity for or on behalf of the RI or one of its group companies principally in a place outside Hong Kong;
- the RI is satisfied that the individual is a fit and proper person to be so engaged for the regulated activity; and
- the RI must implement internal control procedures and maintain records to demonstrate that the above conditions have been satisfied.

4.2.13 The specified particulars of such temporarily engaged staff would also need to be included in the HKMA Register, i.e. they are also relevant individuals. It is therefore the responsibility of the RI to ensure that all temporarily engaged staff are fit and proper to be so engaged for the regulated activity. In assessing the competence of such temporarily engaged staff, authorization by an overseas



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regulator and industry knowledge gained outside Hong Kong will be taken into account.

Continuous professional training

- 4.2.14 To provide assurance that relevant individuals remain competent on a continuing basis, they should receive continuous professional training (CPT) in accordance with the Guidelines on Continuous Professional Training. Such individuals need to attain at least 5 CPT hours per calendar year for each regulated activity in which they are engaging.
- 4.2.15 The minimum CPT requirement for deemed relevant individuals during the transitional period will however remain the same as that under the previous regime, except for any new regulated activity taken up after the commencement of the Securities and Futures Ordinance. For details, refer to the Guidelines on Transitional Arrangements issued by the SFC.
- 4.2.16 Relevant individuals who are under temporary engagement are not required to fulfil the CPT requirements since each period of temporary engagement does not exceed 3 months.
- 4.2.17 The HKMA will not seek to pre-endorse internal training organised by RIs. It may, however, review the relevant training materials in order to form an assessment of the quality of such training. Unless otherwise notified, such training will be deemed to meet the CPT requirements. The HKMA will monitor compliance with the CPT requirements during on-site examinations of the regulated activities of RIs.
- 4.2.18 RIs are responsible for requiring their relevant individuals to update their knowledge and skills continuously through CPT in order to maintain their professional competence and to remain fit and proper. The HKMA will review the fitness and propriety of RIs' relevant individuals in on-site examinations, and may impose higher requirements on CPT hours for individual RIs if it considers this necessary.



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Setting up of policies and procedures and keeping of records

4.2.19 RIs should put in place adequate policies and procedures to ensure that their relevant individuals are and continue to be fit and proper, according to the Fit and Proper Guidelines, the Guidelines on Competence and the Guidelines on Continuous Professional Training. Controls should include, but are not limited to, the following:

- The responsibilities of relevant individuals should be clearly defined and supported by up-to-date job descriptions, organisation charts and levels of authority.
- The qualities required for individual positions in terms of skills, knowledge, experience, and training etc. should be clearly defined.
- RIs should have clearly defined policies and procedures for satisfying themselves about the fitness and propriety of relevant individuals at the time of appointment or recruitment. The possible assessment procedures include:
 - obtaining a self-declaration from the individual regarding such matters that will require notification to the HKMA as mentioned in subsection 5.4 below;
 - inspection of the individual's original documents to evidence educational or professional qualifications (including, where applicable, evidence of having passed the relevant recognised industry qualification and local regulatory framework paper) and membership of any professional bodies or associations;
 - checking public records for evidence of public reprimands, disciplinary actions, personal bankruptcy and judgement debts (and, if the individual is currently a licensed representative



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- or a relevant individual, inspecting the SFC register or the HKMA Register respectively);
- obtaining references from previous employers and from referees nominated by the individual; and
- reviewing the record and past performance of the individual who is an existing employee.
- RIs should maintain records and documentary evidence in relation to their assessment in determining how each relevant individual meets the requirements of the Guidelines on Competence. The records and documentary evidence should cover details (including the relevant dates) of the post secondary education attained, professional and vocational courses attended and qualifications achieved, as well as employment history. These should be made available for inspection when required by the HKMA.
- RIs should have clearly defined systems for appraising the performance of relevant individuals. Such systems should give due weight to compliance with internal guidelines and legal and regulatory requirements.
- RIs should design and implement a continuous training programme that best suits the needs of their relevant individuals. This should be subject to annual evaluation with a view to prioritising the training needs of their relevant individuals.
- Records and documentary evidence of attendance or completion of training should be maintained to record the CPT activities undertaken by each relevant individual. These should be kept for a minimum of 3 years and produced for inspection when required by the HKMA.



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- There should be designated personnel responsible for ensuring all relevant individuals of the RI are fit and proper in accordance with regulatory requirements and internal guidelines.
- RIs should have clearly defined policies and procedures for investigating apparent breaches of internal guidelines or legal or regulatory requirements by relevant individuals or complaints about the conduct of such individuals. In the course of such investigation, a RI should conduct a thorough assessment to determine whether the individual is fit and proper. The assessment should be properly documented. Any doubt about the individual's fitness and propriety should be cleared before he can be appointed as a relevant individual or allowed to carry on his existing duties as a relevant individual.
- There should be clearly defined policies and procedures for taking internal disciplinary action where this is appropriate.

4.3 Code of Conduct for Persons Licensed by or Registered with the SFC

4.3.1 The major principles of the SFC Code are:

- honesty and fairness;
- diligence;
- capabilities;
- information about clients;
- client agreement;
- discretionary accounts;
- information for clients;
- client priority;
- conflicts of interest;



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- client assets;
- compliance;
- rebates, soft dollars, and connected transactions;
- responsibility of senior management; and
- professional investors.

4.3.2 The SFC has issued a circular reminding intermediaries to comply with suitability and fair dealing requirements in respect of equity-linked instruments. This circular highlights some key measures that intermediaries are expected to observe in order to ensure adequate investor protection with regard to equity-linked instruments (including equity-linked notes, equity-linked deposits and equity-linked contracts). The circular reiterates the SFC Code principles of know-your-client, reasonable advice, and proper risk disclosure. RIs are also encouraged to distribute the SFC leaflet “Invest Wisely” to retail customers before the latter enter into equity-linked instrument transactions. RIs may contact the SFC to obtain copies of the leaflet for distribution to clients.

4.4 Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC

4.4.1 These guidelines amplify para. 4.3 of the SFC Code, which deals with the requirement to have satisfactory internal control procedures and financial and operational capabilities. They cover:

- management and supervision;
- segregation of duties and functions;
- staff and training;
- information management;
- compliance;
- audit;
- operational controls; and



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- risk management.

4.4.2 RIs should refer to the guidelines for recommended control techniques and procedures in relation to:

- opening and handling customer accounts;
- providing investment advice;
- dealing practices;
- Chinese walls;
- back office and accounting;
- asset protection; and
- risk management.

4.5 Client Identity Rule Policy

4.5.1 This policy explains the client identity rule in para. 5.4 of the SFC Code. RIs should make reasonable efforts to establish and record the identity of customers (and the ultimate beneficial owners of accounts, if different) before entering into any transactions on their behalf. They should also provide the SFC, or the exchanges in Hong Kong (“the regulators” for this purpose) with this information within two business days if the regulators so request.

4.5.2 Where a RI deals with another intermediary, the RI can enter into an arrangement with the latter to the effect that the information about the ultimate beneficial owner will be provided to the regulators upon request. The RI should be reasonably satisfied about the accuracy of the information obtained and that the information will be provided within the required time upon request.

4.5.3 RIs should refuse the business of those persons who are not prepared to provide the client identity information to the regulators as requested under the policy.

4.6 Regulatory requirements for marketing collective investment schemes



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Marketing hedge funds

- 4.6.1 The SFC circular to intermediaries regarding the marketing of hedge funds highlights the key requirements that should be observed when marketing hedge funds to investors. The SFC has also issued investor education leaflets, in English and Chinese, titled “How Much Do You Know About Hedge Funds” which explains the concepts and risks of hedge funds and “Ten Questions to Ask Before Investing in a Fund” which provides a checklist of questions on collective investment schemes (CIS) in general as well as additional questions on hedge funds to help investors make informed investment decisions.
- 4.6.2 RIs should ensure that appropriate procedures are in place to provide customers with relevant, balanced and responsible investor education materials when marketing hedge funds. RIs are therefore encouraged to distribute the two SFC leaflets to retail customers before the latter enter into hedge fund transactions. RIs may contact the SFC for copies of the leaflets.

Marketing CIS in general

- 4.6.3 To provide customers with sufficient information for investment decisions, RIs should ensure that retail customers are provided with the SFC leaflet “Ten Questions to Ask Before Investing in a Fund” before such customers enter into any CIS transaction. RIs should also take the initiative to provide customers with clear and unambiguous answers to those questions set out in the leaflet. Moreover, according to the SFC Code on Unit Trusts and Mutual Funds, for any customer who is not a holder of a particular CIS, no application form may be supplied unless accompanied by the offering document, as well as the scheme’s most recent audited annual report and accounts together with any subsequently published semi-annual report.
- 4.6.4 Another important issue is the assessment of client suitability in relation to a particular CIS. As set out in the



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SFC Code and the SFC circular to intermediaries regarding the marketing of hedge funds, RIs should establish the financial situation, investment experience and objectives, as well as risk tolerance of the customer in order to assess whether the latter is suitable for a particular investment. This is regardless of whether investment advice is being given to the customer.

4.6.5 In addition, according to the SFC Code, RIs are required to act with due skill, care and diligence and in the best interests of their clients. RIs are therefore expected to adopt more stringent due diligence measures in the marketing of investment products to the more vulnerable customers (e.g. the elderly). There should be proper procedures and training for front-line staff with regard to the marketing of investment products to such customers. The relevant procedures should give due weight to the following:

- explaining to the customers the nature of the product, fees and charges (including penalty charges on early redemption, if applicable), and underlying risks (e.g. market risk, liquidity risk, and foreign exchange risk) before they enter into any transaction in the investment product; and
- reminding the customers to avoid hasty investment decisions and, where necessary, seek independent advice on products and markets with which they are not familiar.

4.6.6 RIs may visit the SFC-operated Electronic Investor Resources Centre at www.hkeirc.org for further investor education information on hedge funds and other CIS.

4.7 Regulatory requirements for providing automated trading services and other electronic activities

4.7.1 The SFC Guidelines for the Regulation of Automated Trading Services set out the principles, procedures and standards in relation to the registration in Type 7 regulated activity. The guidelines have identified the following core



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standards of practice that should be followed by persons providing automated trading services. These include:

- financial resources and risk management;
- operational integrity;
- fitness;
- record keeping;
- transparency;
- surveillance; and
- reporting.

4.7.2 Failure to follow the above standards may reflect adversely on the fitness and propriety of a RI to continue to be registered for Type 7 regulated activity.

4.7.3 The following documents also provide guidance on the application of the SFC Code and the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC to activities over the internet and other electronic means of on-line trading.

4.7.4 The SFC has issued a circular to intermediaries providing guidance on internet regulation. The circular clarifies the regulatory standards in relation to securities dealing, the issue of advertisements relating to securities, investment arrangements and investment advisory services, as well as the making of offers of securities and investment arrangements, etc. over the internet or via other electronic means. It also highlights specific requirements for client agreements and the information to be provided to customers in such circumstances.

4.7.5 The SFC has issued another circular to intermediaries regarding the use of the internet to collect applications for securities in an Initial Public Offering. According to the circular, an eIPO service provider should ensure the electronic prospectus is identical to the paper prospectus and the relevant sections of its website are presented in



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both Chinese and English. It should display a statement with required contents on its website to alert applicants. The circular also imposes requirements for the terms and conditions governing the relationships between the eIPO service provider, the issuing company, the vendor of the securities and the applicant, as well as the application procedures, website design and operation and system integrity.

4.8 Regulatory requirements for advising on corporate finance

- 4.8.1 The principal documents are the Corporate Finance Adviser Code of Conduct and the Codes on Takeovers and Mergers and Share Repurchases.
- 4.8.2 The Corporate Finance Adviser Code of Conduct sets out the standards for RIs engaging in Type 6 regulated activity (Corporate Finance Advisers) on:
- conduct of business;
 - competence;
 - conflicts of interest;
 - standard of work;
 - duties to the client;
 - communications with regulators (including the HKMA, the SFC and the Stock Exchange of Hong Kong Limited); and
 - personal account dealings.
- 4.8.3 Corporate Finance Advisers should maintain proper books and records, and be able to provide a proper trail of work done upon request by the HKMA.
- 4.8.4 It is part of the financial and other professional advisers' responsibility to use all reasonable efforts to ensure that their customers understand, and abide by, the requirements of the Codes on Takeovers and Mergers and Share Repurchases.



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4.8.5 Under the Codes on Takeovers and Mergers and Share Repurchases, RIs advising on corporate finance should seek to achieve fair treatment for shareholders who are affected by takeovers, mergers and share repurchases. The Codes contain General Principles of Conduct and specific Rules which emphasise:

- equality of treatment of shareholders;
- disclosure of timely and adequate information to enable shareholders to make informed decisions as to the merits of an offer; and
- a fair and informed market in the shares of companies affected by takeovers, mergers and share repurchases.

4.9 Regulatory requirements for asset management

4.9.1 The main document is the Fund Manager Code of Conduct. It sets out conduct requirements for persons whose business involves the discretionary management of collective investment schemes. Where the Fund Manager Code of Conduct applies, it applies to the entire discretionary management business of the persons concerned, whether it relates to collective investment schemes or segregated portfolios. Fund managers are also required to comply with the SFC Code in relation to their discretionary management business other than the management of collective investment schemes. In case of any inconsistency between the SFC Code and the Fund Manager Code of Conduct, the more stringent provision will apply.

4.9.2 Minimum standards of conduct include:

- Chinese walls to prevent the flow of confidential or price-sensitive information between different operational areas;
- proper segregation of duties;



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- internal rules on personal account dealing to give customers priority and avoid conflicts of interest;
- ensuring transactions are in accordance with the portfolio's stated objectives, investment restrictions and guidelines;
- best execution for customer orders, fair and prompt order allocation and sufficient safeguarding of customer assets;
- prohibition on insider dealing; and
- restrictions on transactions with connected persons and cross trades between house accounts and client accounts.

4.9.3 The Fund Manager Code of Conduct also stipulates operational requirements covering records, audits, portfolio valuation, reconciliation, dealing with customers (such as account opening procedures, client agreements, periodic statements and performance reviews), marketing activities, fees and expenses.

4.10 Regulatory requirements for prevention of money laundering and terrorist financing

4.10.1 In addition to the Guideline on Prevention of Money Laundering (including its Supplement) issued by the HKMA, RIs and associated entities that are AIs are required to have regard to Appendix B(ii) to the SFC's Guidance Note on Money Laundering and Terrorist Financing in identifying securities or futures sector-specific suspicious transactions.

5. Reporting of certain events

5.1 Under §135 of the Securities and Futures Ordinance, a RI is required to notify both the SFC and the HKMA in writing of the following events and within the specified time limits:

- at least 7 business days' advance notice of any intended cessation of any regulated activity;



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- at least 7 business days' advance notice of any intended change of address at which it proposes to carry on any regulated activity¹³; and
 - a notice (together with full description of the change) within 7 business days of any change in the information as specified in Part 2 of Schedule 3 to the Securities and Futures (Licensing and Registration)(Information) Rules.
- 5.2 It should be noted that some of the rules made under the Securities and Futures Ordinance contain the specific requirement of notifying the SFC of a breach of certain provisions in such rules. AIs should study all the applicable rules to ensure compliance with their reporting obligations.
- 5.3 Every AI should notify the HKMA as soon as practicable of the breach of any provision of the Banking (Amendment) Ordinance 2002, and the Securities and Futures Ordinance (including its subsidiary legislation), where the breach is committed by:
- the AI itself being an intermediary or an associated entity of another intermediary; or
 - its associated entity.
- 5.4 In line with the reporting requirements imposed by the SFC on licensed representatives under the Securities and Futures (Licensing and Registration)(Information) Rules, RIs are required to notify the HKMA in writing within 7 business days upon knowledge of certain information (including any subsequent changes) of any of their relevant individuals, whether deemed or otherwise. The required information is on whether or not the person is or has been, in Hong Kong or elsewhere:

¹³ The SFC adopts a pragmatic approach and only requires RIs to notify any intended change in the principal place for carrying on regulated activities (i.e. the main location for receiving orders from clients or meeting with clients).



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- convicted of or charged with any criminal offence (other than a minor offence¹⁴) whether or not evidence of such conviction is admissible in proceedings in Hong Kong or elsewhere;
- subject to any disciplinary action or investigation¹⁵ by a regulatory body¹⁶ or criminal investigatory body¹⁷ (as the case may be);
- subject to any order of the court or other competent authority for fraud, dishonesty or misfeasance;
- a substantial shareholder or director of a corporation or business that is or has been subject to any disciplinary action or investigation¹³ by a regulatory body¹⁴ or criminal investigatory body¹⁵ (as the case may be), or involved in the management of such corporation or business;
- a substantial shareholder or director of a corporation or business that is or has been subject to any order of the court or other competent authority for fraud, dishonesty or misfeasance, or involved in the management of such corporation or business;
- engaged in any judicial or other proceedings;

¹⁴ “Minor offence” means an offence punishable by a fixed penalty under the Fixed Penalty (Traffic Contraventions) Ordinance (Cap. 237), the Fixed Penalty (Criminal Proceedings) Ordinance (Cap. 240) or the Fixed Penalty (Public Cleanliness Offences) Ordinance (Cap. 570), or offence of a similar nature committed in a place outside Hong Kong.

¹⁵ Subsection 5.4 does not include disclosure of information concerning an ongoing criminal investigation by a regulatory body or criminal investigatory body if such disclosure is prohibited by any statutory provision in Hong Kong or elsewhere. RIs are however required to notify the HKMA of the results of the investigation with 7 business days after they become aware of the completion of such criminal investigation.

¹⁶ “Regulatory body” includes the SFC, the MA, a recognized exchange company (as defined in Schedule 1 of the Securities and Futures Ordinance), any professional body or association, an examination authority, an inspector appointed under any enactment, and other equivalent bodies or persons, in Hong Kong or elsewhere.

¹⁷ “Criminal investigatory body” means the Hong Kong Police Force and the Independent Commission Against Corruption established under §3 of the Independent Commission Against Corruption Ordinance (Cap. 204), and public bodies in Hong Kong or elsewhere carrying out criminal investigations.



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- a party to a scheme of arrangement, or any form of compromise, with his creditors;
- in default of compliance with any judgement or court order;
- a substantial shareholder or director of a corporation or business which was wound up otherwise than by way of a member's voluntary winding up, or involved in the management of such corporation or business;
- a partner of a firm which was dissolved other than with the consent of all the partners;
- bankrupt or aware of the existence of any matters that might render him insolvent or lead to the appointment of a receiver of his property under the Bankruptcy Ordinance (Cap. 6);
- refused or restricted from the right to carry on any trade, business or profession for which a specific licence, registration or other authorization is required by law;
- a substantial shareholder or director of a corporation that has been refused or restricted from the right to carry on any trade, business or profession for which a specific licence, registration or other authorization is required by law, or involved in the management of such corporation;
- disqualified from holding the office of director; or
- a patient as defined in §2 of the Mental Health Ordinance (Cap. 136).

5.5 RIs should have procedures and systems in place to meet the reporting requirements. The requirements under subsection 5.4 above should also be clearly communicated to all relevant individuals.

6. Disciplinary actions

6.1 Disciplinary actions in respect of RIs, their relevant individuals and persons involved in the management of their regulated activities are



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set out in Part IX of the Securities and Futures Ordinance and §§58A and 71C of the Banking Ordinance.

6.2 Under Part IX of the Securities and Futures Ordinance, the SFC may exercise any of the following powers where the above persons are guilty of misconduct or considered to be not fit and proper:

- revocation or suspension of registration for all or part of the regulated activities (only applicable to RIs);
- public or private reprimand;
- prohibition from applying for licence or registration;
- prohibition from applying for approval as an executive officer of a RI or a responsible officer of a licensed corporation (only applicable to individuals);
- prohibition from having his name entered in the HKMA Register (only applicable to individuals); and
- ordering the paying of a pecuniary penalty.

6.3 §§58A and 71C of the Banking Ordinance empower the MA to impose any of the following disciplinary sanctions on a relevant individual who is guilty of misconduct or considered to be not fit and proper, or on an executive officer who is no longer considered to have sufficient authority within a RI to act in such capacity:

- removal or suspension of all or part of the relevant individual's information contained in the HKMA Register. This in effect prohibits the individual from engaging in any regulated function of any regulated activity of the RI, either permanently or temporarily; and
- in the case of an executive officer, withdrawal or suspension of the consent given by the MA.

6.4 The SFC and the MA are subject to the following statutory procedural requirements for the exercise of the above powers:



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- before the exercise of any of such powers, the other regulator will be consulted and the person concerned will be given a reasonable opportunity to be heard; and
- where the regulator decides to exercise the relevant power, the person concerned will be informed of the decision by written notice.

6.5 It is essential for the senior management to draw to the attention of their relevant individuals and persons involved in the management of the regulated activities that they shall be personally and legally liable to these disciplinary sanctions if they are found guilty of misconduct and/or considered to be not fit and proper.

6.6 The Securities and Futures Appeals Tribunal (“SFAT”) has jurisdiction to review all decisions about disciplinary actions made by the MA and the SFC in respect of the regulated activities of RIs and their relevant individuals, upon appeal by the latter. The SFAT shall have at its disposal the full range of disciplinary sanctions administered by both regulators in considering an appeal. Being the single appellate body, the SFAT will ensure consistency in the nature and degree of disciplinary sanctions applied by the regulators in similar circumstances.

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