

Securities-Related Activities of Authorized Institutions

by the Banking Development Department

In the June 2003 issue of this *Bulletin*, guidance in respect of some frequently raised questions was provided to registered institutions (RIs), i.e. authorized institutions (AIs) that are registered (or deemed to have been registered during the two-year transitional period) with the Securities and Futures Commission (SFC).

This memo will focus on practical guidance in relation to non-compliance with the Securities and Futures Ordinance (SFO), applications for registration with the SFC and for the HKMA consent to the appointment of executive officers (EOs), as well as registration of relevant individuals with the HKMA.

Non-compliance with the SFO

Q1. In case of a breach of the SFO or its subsidiary legislation, should an RI notify the SFC or the HKMA? How should such a notification be made?

A1. An RI should notify the HKMA as soon as practicable of the breach of any provision of the SFO (including rules made under the SFO), committed by itself being an intermediary or being an associated entity of another intermediary, or by its associated entity¹. The notification should be made in writing, by fax or email, to the responsible case officer in the Banking Supervision Department of the HKMA.

Apart from notifying the HKMA, an RI is also required to report to the SFC within one business day of becoming aware of its breach of certain specified provisions in some of the rules made under the SFO, e.g. the Securities and Futures (Client Securities) Rules and the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.

¹ Refer to Q5 of the Supervisor's Memo in the June 2003 issue of the *HKMA Quarterly Bulletin* for more guidance in relation to the notification to the HKMA of a breach of the SFO by an associated entity.

The notification to the SFC should be made by fax to 2526-5304 or by email to mmak@hksfc.org.hk.

Q2. What are the procedures for making an application for a waiver or modification of a requirement under the SFO or its subsidiary legislation?

A2. When an RI becomes aware that it or its associated entity is in breach of any provision under the SFO (including rules made under the SFO), it must promptly report the event to the HKMA (and the SFC, where necessary) as mentioned in A1 above.

If an RI considers that there are serious practical difficulties in complying with a requirement and where such requirement relates to a subject that is within the SFC's power to grant a modification or waiver under section 134 of the SFO, it may consider applying for such modification or waiver.

The overriding principle is set out in section 134(3) of the SFO. A modification or waiver will not be granted unless the applicant can satisfy the SFC that the interests of any client or the interest of the investing public (as the case may be) will not be prejudiced.

The RI should contact the HKMA before lodging a formal application to the SFC. The HKMA will review the justification and the adequacy of the information provided, as well as liaise between the SFC and the RI on the conditions that may be imposed, if any.

If the result of the above review is satisfactory, the HKMA will inform the RI to lodge an application to the SFC.

Similarly, an RI should first contact the HKMA in respect of an intended application for the SFC to authorize, under section 165(3) of the SFO, its associated entity to conduct any business other than that of receiving or holding client assets.

Application to Become an RI or an EO

Q3. Is there any practical guidance for RI and EO applicants to facilitate the approval process?

A3. From the HKMA's experience of handling RI and EO applications since 1 April 2003, some of the important points to note are:

(a) Schedule of application

As the timing of AIs' applications has significant impact on the allocation of resources within the HKMA, all deemed RIs have been requested to indicate their planned date of application. In case of any change to the application schedule, the relevant deemed RI should notify the HKMA as soon as practicable.

For questions related to the applications, AIs should contact the HKMA at an early stage to avoid any undue delay.

(b) Board resolution

The SFC's RI application form requires a declaration, among other things, that the board

of directors has passed a resolution approving the application. RI applicants should, therefore, make proper arrangements in advance to ensure that such board resolution is in place before submitting the application. Foreign AIs should take note of this, particularly if it takes time for them to arrange for such a board resolution.

(c) Condition on the scope of regulated activities

The HKMA may advise the SFC to impose condition(s) on an RI's registration in respect of the scope of regulated activities under the following circumstances:

- Where the applicant has indicated no intention to engage in certain activity and the condition is to confine the applicant's scope of activities accordingly: Typical examples are a condition on Type 9 regulated activity (i.e. asset management) that the RI shall not provide a service of managing a portfolio of futures contracts and a condition on Type 6 regulated activity (i.e. advising on corporate finance) that the RI shall not advise on matters / transactions falling within the ambit of the Hong Kong Codes on Takeovers and Mergers and Share Repurchases.
- Where the applicant intends to engage in certain activity but does not have sufficient experience: A typical example is a condition on Type 6 regulated activity that the RI shall not, in the capacity as a sole adviser to a client, advise on matters / transactions falling within the ambit of the Hong Kong Codes on Takeovers and Mergers and Share Repurchases.

(d) Conditional consent for EOs

In general, the conditions imposed on an RI's registration also apply to its EOs in respect of the same regulated activity. Further, EOs may

be subject to additional conditions due to their limitations in qualifications or experience.

According to the SFC Guidelines on Competence, if an EO applicant has met all the initial competence requirements, except the passing of a local regulatory framework paper, the HKMA may grant a conditional consent:

- requiring the applicant to pass the required paper within six months; or
- if the HKMA can be satisfied that the prerequisite requirements² set out in paragraph 6 of Appendix E of the SFC Guidelines on Competence have been met, requiring the applicant to act under the advice of another EO approved for the same regulated activity without this condition.

- (e) Useful information for the HKMA's consideration of an EO application

To facilitate the HKMA in assessing the fitness and propriety of an EO applicant, more specific information (where applicable) should be set out clearly in the relevant parts of the EO application form. Examples are:

- a description of the applicant's specific roles and functions (with respective periods) in relation to each regulated activity, including duties of active involvement in regulatory or compliance work in Hong Kong in securities-related activities, in subsection 3.4; and
- if the EO applicant has enrolled in a recognised initial competence examination or is awaiting the result of such examination, a statement of this fact in subsection 10.3. If the applicant obtains a pass in the examination after submitting the application form, the HKMA should be promptly notified in writing.

² The requirements include, among others, an undertaking from the relevant RI as and when the HKMA considers appropriate.

- (f) Concurrent approval of RI and EO applications

When an AI applies for registration with the SFC as an RI, the SFC's approval for the registration and the HKMA's consent, or provisional consent, for the related EOs will be granted concurrently. This arrangement is derived from the statutory provisions that —

- every RI (other than a deemed RI) must appoint no less than two EOs and no person shall become an EO of an RI without the HKMA's consent; and
- the HKMA's power to give consent to an EO applicant of an RI under section 71C(1), or provisional consent to such individual under section 71E(1), of the Banking Ordinance does not apply in relation to a deemed RI.

Neither regulator is in a position to grant its approval for an RI or the related EOs until the integral process of handling both types of applications have been fully completed.

Registration of Relevant Individuals with the HKMA

Q4. RIs have a statutory obligation to ensure that every relevant individual is fit and proper to be engaged in the conduct of a regulated activity. According to the HKMA's supervisory experience since 1 April 2003, what are the common areas in which RIs should seek improvement in their efforts to discharge this obligation?

- A4. Every RI should establish proper control procedures to ensure that the name and required particulars of a relevant individual should be submitted to the HKMA for inclusion in the HKMA Register prior to the individual being engaged by the RI in respect of any regulated activity. The individual should not act

in that capacity until that individual's name and specified information have been entered in this register. Under normal circumstances, it is envisaged that an entry will be made on the register within five business days after submission to the HKMA³. An RI should therefore submit the name and required particulars of an individual to the HKMA at least five business days before engaging the individual in a particular regulated activity. It should also be noted that an individual being so engaged without these details entered in the register is in breach of section 114(3) of the SFO.

RIs have the responsibility to provide adequate regular training to their relevant individuals on the applicable statutory and regulatory requirements (including those on competence and registration issues), and designate properly qualified personnel (e.g. compliance personnel) to handle the related enquiries from their staff on a day-to-day basis. RIs should have proper controls in place to ensure that their relevant individuals, whether deemed under the transitional arrangements or not, comply with the relevant requirements specified in the SFC Guidelines on Continuous Professional Training.

³ Refer to the HKMA circular "Register of relevant individuals to be maintained by the HKMA under the Banking (Amendment) Ordinance 2002" dated 12 September 2002 available on the HKMA website.