

# Fit and Proper Assessment for Regulated Activities: Points to Note for Registered Institutions and their Relevant Individuals

by the Banking Development Department

This memo seeks to provide important practical guidance to registered institutions (RIs) and their relevant individuals in relation to the fit and proper assessment for the conduct of regulated activities. This is a major subject of enquiries received by the HKMA. Reference has been drawn from relevant publications of the Securities and Futures Commission (SFC), which are available on the SFC public website at [www.hksfc.org.hk](http://www.hksfc.org.hk).

## Competence Requirements for Individuals Seeking to be Relevant Individuals

The SFC has clarified that an individual who has been previously licensed and reappplies within three years from the date of exit from the licensing regime does not have to take any competence examinations before engaging in regulated activities of the same product category and in the same role as previously licensed<sup>1</sup>.

The SFC agrees that the above “3-year recency test” also applies to:

- individuals licensed by the SFC under the former regime;
- individuals who were engaged in securities-related activities by an exempt dealer/exempt investment adviser (“exempt person”) under the former regime; and
- individuals who were engaged in investment advisory activities by a licensed bank under the former regime.

Applying this approach, for an individual who was engaged within the past three years in securities-related activities of an authorized institution (AI) that was an “exempt person”, or investment advisory activities of a licensed bank, and is now seeking to be engaged as a relevant individual of an RI in a regulated activity with the same competence requirements and in the same role: —

- (a) If the individual is eligible for “grandfathering” treatment<sup>2</sup>, the person is considered to have met the full initial competence test.
- (b) If the individual is not eligible for “grandfathering” treatment, the person can still enjoy exemption from the competence examinations — i.e. both recognised industry qualification and local regulatory framework paper by virtue of the “3-year recency test”. However, the person needs to satisfy the other applicable competence requirements that are stipulated in section 5 of the SFC Guidelines on Competence, e.g. academic qualification and/or relevant industry experience and management experience where applicable.

<sup>1</sup> Refer to question 2.3 of the SFC Frequently Asked Questions on licensing matters under the Securities and Futures Ordinance.

<sup>2</sup> Refer to paras 4.2.4 to 4.2.7 of the HKMA Supervisory Policy Manual module SB-1 “Supervision of Regulated Activities of SFC-Registered Authorized Institutions”.

It should be noted that even if an individual can benefit from “grandfathering” treatment or exemption from the competence examinations, the relevant RI has to ensure that such individual has met all other requirements under the SFC Fit and Proper Guidelines before engaging the person as a relevant individual.

### **Illustrative examples**

#### *Example 1*

- Alan was engaged by an exempt dealer AI as a securities dealing staff from June 1995 to December 2002. His functions did not include direct supervision of the conduct of securities-related activities. Alan is not a deemed relevant individual but now seeks to be a relevant individual (other than an executive officer) of an RI. He is eligible for “grandfathering” treatment on the grounds that as of 31 March 2001 he was engaged by an exempt dealer AI in securities dealing. He does not need to take the competence examinations for a representative in respect of types 1, 4, 6 and 9 regulated activities, and he is not required to demonstrate competence in respect of academic qualification and relevant industry experience.
- Assuming that Alan applies to be an executive officer (EO) of an RI, which is a change of role. Regardless of the type(s) of regulated activity(ies) for which he is applying to be an EO, Alan is not eligible for exemption from the competence examinations for a responsible officer. He will have to pass the relevant examinations as well as possess proper academic qualifications, management experience and relevant industry experience in order to fulfil the initial competence test.

#### *Example 2*

- Betty directly supervised the conduct of securities-related activities of an exempt dealer

AI during May 1992 to January 2002. Betty now applies to be an EO of an RI. She cannot benefit from “grandfathering” treatment as immediately before the commencement of the SFO on 1 April 2003, she was not performing any direct supervision over securities-related activities. She is, however, eligible for exemption from the competence examinations for a responsible officer in respect of types 1, 4, 6 and 9 regulated activities by virtue of the “3-year recency test”. She is still required to possess relevant industry experience of at least three years over the past six years and management experience of at least two years.

### **Duty of Relevant Individuals to Disclose Disciplinary Records**

The SFC published an article “Application for re-entry into the industry by persons with disciplinary records” in the September/October 2003 issue of its bi-monthly newsletter for investors and intermediaries, *SFC Alert*. Those who are interested are advised to refer to the article for details.

The article states that the SFC does not prejudge persons who have been disciplined. Similarly, a warning alone should not bar a person from practising in the industry, since a more severe sanction could have been applied if the breach were of a serious nature. However, it emphasises that full and frank disclosure by a licence applicant of any disciplinary record is essential. The fact that a warning has been received from a regulatory organisation should also be disclosed by the applicant to enable the SFC (or other relevant regulators as the case may be) to assess the application on a fully informed basis.

The above principle of disclosure is also applicable to individuals engaged or to be engaged by an RI in the conduct of regulated activities : —

- (a) An individual who is, or will be, engaged by an RI as a relevant individual should disclose,

among other things, the following information to the RI concerned —

- disciplinary action or
- investigation and the results of the investigation, including any warning letter,

by a regulatory body (including the SFC and the HKMA) or criminal investigatory body.

The RI is required to notify the HKMA in writing within seven business days of learning of such information about their relevant individuals<sup>3</sup>.

- (b) An EO applicant is required to make similar disclosure to the HKMA in the application form to be submitted through the RI concerned. Any subsequent change to such information should also be notified to the HKMA in writing.

In addition, if the background checks reveal information that is the subject of disclosure, but for which the HKMA has not been notified, it will consider taking follow-up action, such as —

- informing the RI concerned of the results of the background checks to facilitate the RI in fulfilling its statutory obligation to ensure that its relevant individuals are and remain fit and proper to be so engaged;
- in processing an EO application, giving due weight to the failure of the applicant to disclose the information;
- requiring the RI concerned to explain the reason for not making a prompt notification to the HKMA given the requirement to report such information.

## Background Checks by the HKMA

The HKMA conducts background checks on relevant individuals (including EO applicants). If the HKMA becomes aware that an individual has been disciplined or warned (by the SFC or other regulators), it will consider each case on its merits. Possible decisions include:

- (a) requiring appropriate action on the part of the RI concerned; and/or
- (b) imposing condition(s) on the consent to be given, or refusing to give consent, if the individual is an EO applicant.

The guiding principle is to ensure consistency with the SFC's licensing decision in respect of similar cases, including, as mentioned above, the position that a warning alone should not bar a person from practising in the industry.

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<sup>3</sup> Refer to para 4.2.19 and subsection 5.4 of the HKMA Supervisory Policy Manual module SB-1 "Supervision of Regulated Activities of SFC-Registered Authorized Institutions" for details of the disclosure requirements.

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