

Securities-Related Activities of Authorized Institutions: Key Issues for Staff

by the Banking Development Department

Under the new supervisory framework introduced by the Banking (Amendment) Ordinance 2002 and the Securities and Futures Ordinance, which are scheduled to commence operation on 1 April 2003, authorized institutions have to register with the Securities and Futures Commission in order to engage in securities-related activities. The names and certain particulars of their staff engaging in such activities (relevant individuals) must be entered in a new on-line public register on the HKMA public website, which will be made available upon commencement of the new regime. This article sets out some key matters that are of interest to relevant individuals.

INTRODUCTION

There are nine types of regulated activities under the Securities and Futures Ordinance —

- 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.

An authorized institution (AI) may apply for registration with the Securities and Futures Commission (SFC) in one or more regulated activities (other than Type 3 and Type 8 for which AIs will not require registration). Upon such registration, the AI will become a registered institution.

Before engaging any individual in the conduct of one or more regulated activities (other than Type 3 and Type 8) and except for the pure performance of

clerical, settlement and/or accounting functions, a registered institution must ensure that the required particulars of that relevant individual have been entered in the HKMA Register. Such relevant individuals will not require any licence from the SFC.

TRANSITIONAL ARRANGEMENTS

Deemed Registered Institutions

In order to ensure a smooth transition, AIs currently carrying out securities-related activities under the existing regime will become deemed registered institutions on 1 April 2003. They will be given a two-year transitional period to apply to the SFC for registration. This deemed status of an AI will lapse when its application for registration has been approved or refused by the SFC, or at the end of this two-year period if the AI does not lodge an application by that time. When the application for registration is approved, the AI formally becomes a registered institution.

The regulated activities in which an AI will be deemed to be registered will derive from the current status of the AI —

- an AI that is now an exempt dealer will be deemed to be registered in Types 1, 4, 6 and 9 (and also Type 7 if it currently carries on a business of providing automated trading services) activities;
- an AI that is currently an exempt investment adviser, or is a licensed bank currently carrying on investment advisory business, will be deemed to be registered in Types 4, 6 and 9 activities.

There will be an indication of “registered under transitional arrangements” on the HKMA Register to identify those AIs that are deemed registered institutions.

Deemed Relevant Individuals

Depending on the timing of engagement by an AI in securities-related activities, relevant individuals may be categorised into two groups —

(1) Those who are engaged by an AI in such activities as of 31 March 2003 will become deemed relevant individuals of the AI on 1 April 2003 in respect of the specific activities in which they have been engaging. This deemed status of an individual will lapse when:

- the AI which engages such individual ceases to be a deemed registered institution; or
- the individual is no longer engaged in the activities in which he was engaged for that AI as of 31 March 2003.

Alan in examples A1 to A4 (see boxes below) falls within this group.

It should be noted that if such an individual continues to be engaged by an AI in regulated activities after it becomes a registered institution, or if he is engaged by another AI (whether a registered institution or a deemed registered institution) in regulated activities, he formally becomes a relevant individual.

(2) The deemed status of an individual will not be given to those who start to engage in the regulated activities of an AI after 1 April 2003.

Betty in examples B1 to B4 (see boxes below) falls within this group.

It follows that where an individual is not a deemed relevant individual of an AI, this simply means that he was not engaged by that AI in securities-related activities as of 31 March 2003.

The following paragraphs illustrate some important transitional arrangements that will be applicable to deemed relevant individuals during the two-year transitional period —

(a) Relationship between a deemed registered institution and its deemed relevant individuals

The deemed regulated activities of each deemed relevant individual of an AI depends on the actual functions that he performed for that AI as of 31 March 2003.

For each deemed relevant individual, the HKMA Register will provide a clear indication of every regulated activity for which the individual is “registered under transitional arrangements”, i.e. deemed regulated activity.

Example A1 — Deemed relevant individual

MNO Bank is an exempt dealer AI under the existing regime. It will be deemed to be registered in Types 1, 4, 6 and 9 regulated activities. On 1 April 2003, the HKMA Register will indicate that MNO Bank is “registered under transitional arrangements” for Types 1, 4, 6 and 9 regulated activities.

As of 31 March 2003, Alan works for MNO Bank as a customer service officer and is responsible for marketing mutual funds. He is not involved in any investment advisory, corporate finance advisory or asset management activities. Alan will therefore become a deemed relevant individual of MNO Bank only in respect of Type 1 regulated activity. On 1 April 2003, the HKMA Register will indicate that Alan is “registered under transitional arrangements” for Type 1.

On 1 May 2003, Alan is promoted to become a relationship manager. He is now responsible for both marketing mutual funds and managing clients’ securities portfolios. While he will be shown on the HKMA Register as being engaged in Types 1 and 9 regulated activities, the indication of “registered under transitional arrangements” will only be shown for Type 1 because his deemed status only applies to Type 1.

Example B1 — Non-deemed relevant individual

Betty first takes up securities dealing functions when she starts to work for MNO Bank as a securities order-taking staff on 1 June 2003. Since she is not engaged in any securities-related activity as of 31 March 2003, she is not a deemed relevant individual of MNO Bank. She will be shown on the HKMA Register as being engaged in Type 1 regulated activity but there will not be any indication of “registered under transitional arrangements”.

(b) Change of employer

As mentioned above, the deemed status of an individual comes from the functions he is performing for the AI. Upon change of employer under the new regime, the individual will lose his deemed status because he did not work for the new employer before the commencement of the new regime.

The individual will nevertheless still be eligible for the “grandfather” arrangements in respect of initial competence requirements. Refer to the section below for further details.

Example A2 — Deemed relevant individual

On 1 August 2003, Alan ceases to work for MNO Bank. His new employer is PQR Bank, which is an exempt investment adviser AI under the existing regime, and is deemed to be registered in Types 4, 6 and 9 regulated activities. His new duty is to manage clients’ securities portfolios.

Although PQR Bank is a deemed registered institution, Alan loses his deemed status upon his change of employment because he did not work for PQR Bank as of 31 March 2003. Alan will be shown on the HKMA Register as being engaged in Type 9 regulated activity for PQR Bank. There will be no indication of “registered under transitional arrangements”.

Refer to examples A3 and A4 for the “grandfather” arrangements in relation to competence and continuous professional training requirements applicable to Alan.

Example B2 — Non-deemed relevant individual

Betty terminates her employment with MNO Bank and starts to work for STU Bank on 1 August 2003. STU Bank has been approved by the SFC to become a registered institution in Types 1, 2 and 9 regulated activities. Betty’s new duty is to take orders from retail clients on securities and futures contracts. Her name has to be entered in the HKMA Register as being engaged by STU Bank in Types 1 and 2 regulated activity.

Refer to examples B3 and B4 for the competence and continuous professional training requirements applicable to Betty.

COMPETENCE REQUIREMENTS FOR RELEVANT INDIVIDUALS

General Requirement to be Fit and Proper

All relevant individuals, including deemed relevant individuals, must be fit and proper and remain so on a continuous basis. The Fit and Proper Guidelines and the Guidelines on Competence and Continuous Professional Training to be issued by the SFC under the Securities and Futures Ordinance will specify the standards for assessing the fitness and propriety of relevant individuals.

Competence is one of the key elements in the fit and proper test. There are nevertheless some exemptions in order to facilitate smooth transition of existing securities staff to the new regime.

Exemption from Initial Competence Requirements — “grandfather” arrangements

(a) Scope of exemption - who and what type of regulated activities?

The following relevant individuals will be considered to have met the initial competence requirements:

- (1) Individuals who were, as of 31 March 2001¹, engaged by exempt dealer AIs in securities dealing will be considered to have met the initial competence requirements for Types 1, 4, 6 and 9 regulated activities.
- (2) Individuals who are, as of 31 March 2003, engaged by:
 - licensed banks; or
 - exempt investment adviser AIs,

in the performance of any securities-related activity that would constitute Types 4, 6 or 9 regulated

activities will be considered to have met the initial competence requirements for such activities.

- (3) Individuals who have been considered by the SFC to have met the initial competence requirements (whether by means of “grandfather” arrangements or otherwise) for a licensed representative in relation to a particular regulated activity will also be considered by the HKMA to have met the same requirements to be a relevant individual in the same regulated activity.

(b) No exemption from other fit and proper requirements

For those individuals who benefit from the above “grandfather” arrangements in relation to the initial competence requirements, the respective registered institution / deemed registered institution will have to ensure that they have met all other requirements under the SFC Fit and Proper Guidelines before engaging them in any regulated activity.

(c) Under what circumstances will the “grandfather” arrangements become invalid?

In each of the following situations, the “grandfather” arrangements will not apply —

- *New regulated activities* — At any time (i.e. during and after the two-year transitional period) when an individual takes up any one or more new regulated activities for which he is not eligible to be “grandfathered”, the individual needs to meet the initial competence requirements for each of these new regulated activities.
- *Failing the three-year recency test* — After 1 April 2003, if an individual is eligible to be “grandfathered” but has no engagement in the relevant regulated activities for three years or more, he will need to meet the full initial competence requirements before he can be engaged again in such activities at a later time.

¹ 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.

(d) Will a “grandfathered” individual be required to pass the initial competence examinations after the two-year transitional period?

A “grandfathered” individual will not be required to pass the initial competence examinations, whether during or after the two-year transitional period, unless he falls under any of the situations set out in paragraph (c) above.

Example A3 – Deemed relevant individual

- (i) Assuming that as of 31 March 2001, Alan was employed by MNO Bank as a securities dealing staff. He enjoys the “grandfather” arrangement and does not need to meet the initial competence requirements for Types 1, 4, 6 and 9 regulated activities again. This arrangement is still valid even when he changes employer. Alan will therefore be exempt from the initial competence requirements when he works for PQR Bank in Type 9 regulated activity.
- (ii) Applying a different assumption, if Alan first took up securities dealing functions at MNO Bank on or after 1 April 2001, he should have already met the initial competence requirements as set out in the HKMA circulars of 21 March 2001 and 13 August 2001 before he took up such functions. The “grandfather” arrangement is not relevant.

Example B3 – Non-deemed relevant individual

Betty is not eligible for any “grandfather” arrangement. She has to meet the initial competence test for Type 1 regulated activity before she can be assigned the duties as a securities order-taking staff by MNO Bank on 1 June 2003.

Similarly, before she changes employment to take orders for both securities and futures contracts, Betty has to meet the initial competence requirements for Type 2 regulated activity as well.

On-going Competence Requirements – Continuous Professional Training (CPT)

(a) Deemed relevant individuals

For any deemed relevant individual, throughout the two-year transitional period (even when his employer has become a registered institution),

- *for his deemed regulated activities* — Whatever the individual’s total number of deemed regulated activities, he will only have to undertake 5 CPT hours per calendar year for each exemption obtained under the existing regime by the AI under which he acquires his deemed status; and
- *for other regulated activities that he engages in* — He will have to undertake 5 CPT hours per calendar year for each of these new regulated activities.

After the end of the two-year transitional period, the previously deemed relevant individuals will have to follow the same CPT requirements as those individuals who have never acquired the deemed status, i.e. undertake 5 CPT hours per calendar year for each regulated activity in which they are engaged.

(b) Non-deemed relevant individuals

For relevant individuals who are not deemed, counting from the first day of engagement under the new regime, they will have to undertake 5 CPT hours per calendar year for each regulated activity in which they are engaged.

Example A4 – Deemed relevant individual

Alan is a deemed relevant individual for a former exempt dealer (i.e. one exemption for MNO Bank under which Alan acquires his deemed status). He has to undertake –

- 5 CPT hours per calendar year x 1 (i.e. number of exemption) x 1/12 (months) for his engagement in Type 1 regulated activity only by MNO Bank during April 2003; *and*
- 5 CPT hours per calendar year x 2 (i.e. number of exemption + number of new regulated activities) x 3/12 (months) for his engagement in Types 1 and 9 regulated activities by MNO Bank from May to July 2003; *and*
- 5 CPT hours per calendar year x 1 (i.e. number of regulated activities he engages in) x 5/12 (months) for his engagement in Type 9 by PQR Bank from August to December 2003.

Alan's total CPT hours will therefore be 5 for the period from April to December 2003. Including the CPT hours required under the existing regime (i.e. 5 x 3/12 months for January to March 2003), Alan will need to undertake at least 6.25 CPT hours for the calendar year of 2003.

Counting from 1 April 2005 (i.e. upon expiry of the two-year transitional period), if Alan is engaged in Type 9 regulated activity by PQR Bank, he will have to undertake –

5 CPT hours per calendar year x 1 (i.e. number of regulated activities he engages in for PQR Bank) = 5 CPT hours per calendar year

Example B4 – Non-deemed relevant individual

Betty is not a deemed relevant individual. For the calendar year of 2003, she is subject to the requirement of –

- 5 CPT hours per calendar year x 1 (i.e. number of regulated activities she engages in) x 2/12 (months) for her engagement in Type 1 regulated activity by MNO Bank from June to July 2003; *and*
- 5 CPT hours per calendar year x 2 (i.e. number of regulated activities she engages in) x 5/12 (months) for her engagement in Types 1 and 2 regulated activities by STU Bank from August to December 2003.

Betty's total CPT hours will therefore be 5 for the calendar year of 2003.

(c) Keeping CPT records

Registered institutions (whether deemed or not) should maintain adequate records of the training programme and the CPT activities undertaken by staff. All relevant individuals, including those deemed ones, are also required to retain adequate records of all CPT activities completed in a calendar year. Adequate documentary evidence to support attendance or completion of CPT activities should be kept for a minimum period of 3 years.

THE HKMA REGISTER OF RELEVANT INDIVIDUALS**Responsibility to Provide Information of Relevant Individuals to the HKMA for the Purpose of the HKMA Register**

Every registered institution (whether deemed or not) is responsible for the provision of information on its relevant individuals to the HKMA. In order to facilitate the submission of information, the institution is required to establish adequate system and procedures to:

- capture the required details of all its relevant individuals (whether deemed or not), with clear indication of the deemed regulated activity for each individual (where applicable);
- ensure timely reporting of any change to these particulars by its relevant individuals;
- promptly update the internal database in respect of any change to these particulars; and
- submit the information to the HKMA on a timely basis (see below).

Submitting Information to the HKMA

- (1) All deemed registered institutions should submit, by means of a spreadsheet, the particulars of their deemed relevant individuals as of 28 February 2003. The submission should be performed no later than 3 March 2003. The list will have to be

updated for changes through on-line web-based submission throughout March 2003. The updated position as of 31 March 2003 will form the HKMA database of deemed relevant individuals.

- (2) Starting from 1 April 2003, all submissions relating to relevant individuals must be effected by the same on-line web-based mechanism.
- (3) Starting from 1 April 2003, before a registered institution / deemed registered institution may engage —
- a deemed relevant individual in a regulated activity for which the individual does not have deemed status; or
 - a non-deemed relevant individual in any regulated activity,

that AI must ensure that the individual's name as well as the record of his / her engagement in the new type of regulated activity appears on the HKMA Register. To allow for the HKMA's internal procedures, an entry will normally be made on the HKMA Register within five business days after submission to the HKMA.

- (4) It is therefore necessary for an institution to ensure that —
- submission of information for an individual in respect of a new regulated activity should be made at least five business days in advance; and
 - the corresponding record appears on the HKMA Register,
- before the relevant new engagement takes effect.
- (5) For other changes of information, notification must be made to the HKMA within 7 business days of such changes. This applies to information relating to both deemed and non-deemed relevant individuals.

Personal Data Privacy

There are certain personal data (including nationality, Hong Kong Identity Card/passport number and date of birth) that will be collected by the HKMA for administrative purposes. These will not be included in the HKMA Register for public inspection.

The HKMA will, however, pass such information to the SFC and, if necessary, other relevant (e.g. law enforcement) agencies for background checks. The HKMA will treat all data about the individuals concerned in accordance with the Personal Data (Privacy) Ordinance.

REMAINING FIT AND PROPER

Registered institutions should ensure that all their relevant individuals are fit and proper before engaging them in any regulated activity, and that they remain fit and proper on an on-going basis. It is therefore of extreme importance that registered institutions and relevant individuals, whether deemed or not, observe all applicable legal and regulatory requirements.

Relevant individuals (including the deemed ones) should be fully aware that they will be personally and legally liable to disciplinary sanctions if they are found guilty of misconduct and/or considered to be not fit and proper.