



Circulars

05 Jul 2002

Banking (Amendment) Ordinance 2002 and Securities and Futures Ordinance

Our Ref : G4/26/5C
B1/15C

5 July 2002

To: The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Banking (Amendment) Ordinance 2002 and Securities and Futures Ordinance

Introduction

You will be aware of the recent enactment of the Banking (Amendment) Ordinance 2002 (BAO 2002) and the Securities and Futures Ordinance (SFO). Gazette copies (No. 13, Vol. 6, Legal Supplement 1) of the two Ordinances are available on the website of the Hong Kong Government at <http://www.info.gov.hk>. These will commence operation after the subsidiary legislation of the SFO is ready. I shall write to notify you the commencement date when it is fixed.

The SFO, which consolidates ten separate ordinances governing the securities and futures markets into one comprehensive ordinance, has introduced a number of significant changes to the existing regulatory framework. In the light of this, the BAO 2002 has introduced various corresponding amendments to the Banking Ordinance (BO). To facilitate a better understanding of the SFO, an article entitled "The Securities and Futures Ordinance, 2002 - Continuity and Change", which has been issued by the Securities and Futures Commission (SFC) and provides an overview of the Ordinance, is attached at [Annex 1](#) for your reference.

The new supervisory regime

This circular highlights the salient features of the SFO and the revised provisions of the BO, focussing on those major changes to the existing regulatory regime which will affect authorized institutions (AIs) that are carrying on or intend to carry on regulated activities as defined in the SFO. You are advised to pay particular attention to the section on transitional arrangements.

(A) Registration to become registered institutions (RIs)

There will be two types of intermediaries under the SFO: licensed corporations and RIs. According to Part V of the SFO, an AI may apply for a single registration with the SFC if it intends to engage in one or more regulated activities set out in Schedule 5 of the SFO (other than leveraged foreign exchange trading and securities margin financing, for which AIs will **not** require registration with the SFC). The regulated activities under the SFO 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
- Type 9: asset management

AIs' applications will be referred to the HKMA. The latter will advise the SFC whether an applicant is considered to be fit and proper for registration. Upon registration under section 119 of the SFO, a RI will be granted a certificate of registration.

(B) Register of relevant individuals¹

The revised section 20 of the BO extends the coverage of the register currently maintained by the HKMA to contain also specified particulars of every relevant individual of a RI.

It should be noted that only those individuals whose names are entered, or deemed to have been entered during the transitional period (refer to section (F) for details of transitional arrangements), in the register may engage in any regulated function² of any regulated activity of a RI.

(C) Appointment of executive officers (EOs)

Sections 71C to 71E of the revised BO introduce new requirements in respect of EOs. Every RI shall appoint not less than **two** EOs to be responsible for directly supervising the conduct of each regulated activity. As stipulated in section 119 of the SFO, it shall be a condition of registration that for each regulated activity, there is at least one EO available at all times to supervise the business.

An EO must be an individual who has sufficient authority within the institution to be such officer. The same individual may be appointed to be an EO for one or more regulated activities.

No person shall become an EO of a RI without the HKMA's consent in writing. The HKMA may give, refuse to give, suspend, withdraw or attach conditions to such consent. In considering the fitness and propriety of an individual for this purpose, the HKMA will have regard to the factors set out in section 129 of the SFO. Moreover, the BAO 2002 adds a new ground for revocation of authorization to the Eighth Schedule of the BO where a person has become or continues to be an EO of an AI in contravention of section 71C.

As a general guideline on the appointment of EOs, 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 an institution, the HKMA would expect such person to be appointed as an EO. Where such appointments would result in less than two EOs for any regulated activity, the appointment of the remaining EO(s) should be based upon seniority. In other words, the EOs for each regulated activity should be the relevant individuals in the highest rank according to the RI's internal ranking. Notwithstanding these general guidelines, the HKMA must be satisfied, among other things, that the appointed EOs 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 EOs.

By the nature of their engagement in regulated activities and also as indicated above, EOs are relevant individuals and hence their specified particulars will be entered in the HKMA register.

(D) Fitness and propriety of relevant individuals

Under the new regime, it shall be a statutory condition of registration for a RI to ensure that its relevant individuals are fit and proper. The BAO 2002 adds a new authorization criterion to the Seventh Schedule of the BO requiring that the HKMA is satisfied with the fitness and propriety of each person who is, or is to be, an EO.

In the light of the above statutory requirements, RIs are obliged to ensure compliance with the Fit and Proper Criteria and the supplementary guidance notes issued by the SFC. The HKMA expects RIs' EOs to meet the fit and proper requirements applicable to the responsible officers of licensed corporations. Other relevant individuals of RIs should satisfy the requirements for licensed representatives. The HKMA is discussing with the SFC any transitional arrangements that may apply.

(E) Rules, codes and guidelines to be issued by the SFC

Sections 397 and 399 of the SFO provide the SFC with powers to make subsidiary legislation (rules) and non-statutory codes and guidelines. It should be noted that certain requirements contained in the rules, codes and guidelines on practices and standards will apply equally to the conduct of regulated activities by RIs. In this regard, a list which sets out those SFC rules, codes and guidelines that are applicable to RIs in respect of their regulated activities will be provided in due course.

In particular, the following rules, codes and guidelines to be issued by the SFC under parts VI and VII of the SFO will be applicable to the conduct of regulated activities by RIs (section 63B of the revised BO provides that auditors of RIs will be required to submit to the HKMA a report in writing if they become aware of any failure on the part of the RIs to comply with the rules listed below):

Rules

- Securities and Futures (Client Securities) Rules;
- Securities and Futures (Keeping of Records) Rules; and

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

Codes and Guidelines³

- Code of Conduct for Persons Registered with the SFC;
- Corporate Finance Adviser Code of Conduct; and
- Fund Manager Code of Conduct.

The SFC has established a new section on its website at <http://www.hksfc.org.hk> providing an array of the SFO-related materials, including various consultation and conclusion papers on the subsidiary legislation of the SFO. Moreover, the SFC's web-based ***Regulatory Handbook*** (which is also available on this website) provides a convenient access to the current regulatory codes, guidelines and important circulars issued by the SFC. This electronic handbook will be regularly updated for any new and revised regulatory requirements to be introduced under the new regime.

(F) Transitional arrangements

As stipulated in Schedule 10 of the SFO, there will be a transitional period of two years from the commencement of the Ordinance for the following categories of AIs (collectively "deemed RIs") to apply for migration to the new regime (i.e. to apply for registration with the SFC):

(1) An AI which immediately before the commencement of the SFO is an **exempt dealer** under the to-be-repealed Securities Ordinance shall be 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.

(2) Where an AI falling under (1) above carries on a business in providing **automated trading services** (e.g. providing to investors or other market participants an electronic trading system for securities, which includes dealing through the Internet) immediately before the commencement of the SFO, it shall be deemed to have been registered for Type 7 regulated activity as well.

(3) An AI which immediately before the commencement of the SFO is **either a licensed bank that engages in investment advisory activities or an exempt investment adviser** under the to-be-repealed Securities Ordinance shall be 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.

Where immediately before the commencement of the transitional period, an individual is engaged by a deemed RI to perform any act which would constitute a regulated function in relation to a regulated activity under the SFO, that individual shall be regarded as a relevant individual in respect of that regulated activity and his name shall be deemed to have been entered in the HKMA register during the transitional period.

It is stated in section 71F of the revised BO that the requirements in relation to EOs shall not apply to the deemed RIs during the transitional period. In other words, deemed RIs need not appoint EOs immediately upon commencement of the BAO 2002. They should however submit their proposal of EO appointments for HKMA consent not later than their application to the SFC for registration.

The relevant provisions in the SFO as well as the SFC rules, codes and guidelines will be applicable to the deemed RIs and their relevant individuals upon the start of the transitional period. The deemed RIs will also need to provide the SFC with certain particulars (as specified in the Securities and Futures (Intermediary Information) Rules to be issued by the SFC) for record and inclusion in the SFC register. The SFC and the HKMA should be notified in writing of any change in the particulars reported, within seven business days of the change.

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 HKMA's consent for the EOs to be appointed.

Where an AI not falling under category (1) of deemed RIs carries on a business in providing automated trading services immediately before the commencement of the SFO, it will not enjoy deemed registration with the SFC for Type 7 regulated activity. The AI may nevertheless continue carrying on the business for a period of 6 months from such commencement, during which it and those of its staff that engage in the business will not be subject to the SFO provisions in respect of that business.

To provide more specific guidance to AIs on the transitional arrangements, there will be a briefing session to be conducted jointly by the SFC and the HKMA. Details on the session are provided at [Annex 2](#). The SFC also intends to issue a guidance note on transitional arrangements in due course, to which we will draw your attention.

(G) Associated entities

The SFO introduces a new term "associated entity" (AE), which refers to a company in a controlling entity relationship (as defined in the SFO) with an intermediary and which receives or holds in Hong Kong client assets of the intermediary. An AI may be an AE of a licensed corporation or have one or more AEs of its own. In this connection, AIs should be mindful of the provisions under the SFO as well as the rules to be issued by the SFC which will be applicable to AEs. The major requirements include the following rules to be made under part VI of the SFO:

- Securities and Futures (Client Securities) Rules;
- Securities and Futures (Keeping of Records) Rules;
- Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules; and
- Securities and Futures (Associated Entities) Rules (AEs will be required to report to the SFC certain specified particulars).

(H) The SFC's powers to conduct investigation

Section 182 in Part VIII of the SFO lays down the SFC's powers to conduct investigations in relation to, among others, the regulated activities of RIs. This is in line with the concept that the SFC retains the ultimate authority to regulate the securities and futures industry. The SFC shall nevertheless consult the HKMA before investigating whether a RI or relevant individual is guilty of misconduct, or is not fit and proper to engage in regulated activities. It should also be noted that the HKMA will continue its role as day-to-day supervisor of RIs, and in particular will conduct the routine on-site examinations of their regulated activities.

(I) Disciplinary sanctions

RIs, their relevant individuals and persons involved in the management of their regulated activities will be subject to the same range of sanctions as those applicable to licensed persons. Where they are guilty of misconduct or considered to be not fit and proper, the SFC may exercise any of the following under section 196 of the SFO:

- revocation or suspension of registration of 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 EO 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 payment of a pecuniary penalty.

In addition, sections 58A and 71C of the revised BO empower the HKMA 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 an EO 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 EO, withdrawal or suspension of the consent given by the HKMA.

In any case, consultation with the other regulator will be performed before the exercise of any of the said disciplinary powers and the persons concerned will be given a reasonable opportunity of being heard.

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

(J) Appeals

Part XI of the SFO introduces a new appellate body, namely the Securities and Futures Appeals Tribunal, to deal with appeals against, among others, decisions pertaining to applications to become RIs or EOs as well as disciplinary sanctions in respect of the regulated activities of RIs, their relevant individuals and persons involved in the management

of their regulated activities. It should be noted that this is a different appeal channel from that in the BO. A list of the appealable decisions is set out in Schedule 8 of the SFO.

(K) Exchange of information between the regulators

To facilitate effective supervision, the revised BO and the SFO allow free exchange of information between the SFC and the HKMA in relation to the regulated activities of RIs and Als' businesses of receiving or holding in Hong Kong client assets of intermediaries of which such Als are AEs.

The SFC and the HKMA are working to revise the Memorandum of Understanding between the parties to underpin the new supervisory framework. As in the past, being the front-line supervisor, the HKMA will be responsible for the day-to-day supervision of RIs' conduct of regulated activities according to standards that are in line with those applied by the SFC to licensed persons. The HKMA will also handle the related enquiries from RIs as well as customer complaints against them.

Way forward

With a view to providing specific guidance to Als on the implementation of the new regime, the HKMA intends to issue a series of guidelines and circulars in various areas. These will include:

- survey on Als' plans to register for regulated activities;
- transitional arrangements;
- procedures for Als and their staff to lodge applications to become RIs and EOs respectively;
- public consultation on the pertinent module of the Supervisory Policy Manual;
- commencement of the BAO 2002 and the SFO as well as the subsidiary legislation;
- procedures for Als' submission of the specified particulars of relevant individuals for the purpose of the HKMA register; and
- revised prudential return on securities related activities.

Should you have any questions relating to this letter, please contact Mr. Neville Ng at 2878-8283, Mr. Samuel Leung at 2878-1541 or Miss Alice Lee at 2878-1603.

Yours faithfully,

D T R Carse
Deputy Chief Executive

c.c. The Chairman, HKAB
 The Chairman, DTCA
 SFS (Attn: Miss Kinnie Wong, Miss Vivian Lau)
 SFC (Attn: Mrs Alexa Lam)

Encl.: [Annex 1](#) (PDF file, 176KB)
Annex 2 (Only available to Authorized Institution)

1. Under the revised BO, a "relevant individual" in relation to a RI means an individual who performs for or on behalf of or by an arrangement with the institution any regulated function in a regulated activity.
2. Under the revised BO, a "regulated function" in relation to a regulated activity carried on as a business by a RI means any function performed for or on behalf of or by an arrangement with the institution relating to the regulated activity, other than work ordinarily performed by an accountant, clerk or cashier.
3. These codes and guidelines have been issued by the SFC under the existing regime. They are intended to be revised to incorporate the relevant changes introduced under the SFO.

Last revision date : 01 August 2011