



Circulars

13 Jun 2007

Controls to ensure compliance with Section 114(3) of the Securities and Futures Ordinance (SFO) and Section 20(4) of the Banking Ordinance (BO)

Our Ref.: B1/15C
G16/1C

13 June 2007

The Chief Executive
All Registered Institutions

Dear Sir/Madam,

Controls to ensure compliance with Section 114(3) of the Securities and Futures Ordinance (SFO) and Section 20(4) of the Banking Ordinance (BO)

I am writing to remind registered institutions (RIs) of the importance of having adequate controls to ensure compliance with the prohibition of unregistered dealing under section 114(3) of the SFO. RIs should also promptly notify the HKMA of changes to information related to relevant individuals¹ pursuant to section 20(4) of the BO.

Under section 114(3) of the SFO, no person shall perform any regulated function in relation to a regulated activity carried on as a business or hold himself out as performing any regulated function, unless such person carries on for a RI a regulated activity for which the RI is registered and his name is entered in the register maintained under section 20 of the BO. A person who, without reasonable excuse, contravenes section 114(3) of the SFO **commits an offence**². It is therefore important to note that:

- (a) a person who knowingly allows or facilitates an individual who is not a relevant individual to engage in any regulated function in relation to a regulated activity for a RI may be regarded as aiding and abetting a breach of section 114(3) of the SFO, and **his fitness and propriety for being a relevant individual may be called into question**; and
- (b) a RI and its staff members supervising the relevant lines of business may be subject to disciplinary action for inadequate controls and lack of supervision of staff to ensure compliance with section 114(3) of the SFO.

Since the commencement of the SFO in April 2003, we have come across several cases of suspected unregistered dealings involving staff members of RIs. In ensuring compliance

with section 114(3) of the SFO, RIs should put in place adequate control procedures to avoid possible unregistered dealings. These should include, among others, the following:

- (a) Staff members who are not relevant individuals should not be instructed or allowed to take part in receiving orders relating to securities or futures contracts from clients or execution of such orders. This restriction applies also to those personnel who provide administrative or secretarial support to frontline staff.
- (b) Staff members who are not relevant individuals may sometimes be required to communicate with clients, such as taking messages of telephone calls. Such activities may be performed as a regular duty or only on an ad hoc basis, particularly when the responsible relevant individuals are on leave or out of office. If staff members are in doubt whether performance of such activities will become engaging in any regulated function in relation to a regulated activity, they should consult a relevant individual on this matter. RIs should also provide adequate guidance to the staff members concerned on how to deal with the possible scenarios as well as to refer the clients to a relevant individual who is registered for the appropriate type of regulated activity (e.g. Type 1 for orders relating to securities).
- (c) Whenever staff members (e.g. supervisor of / frontline staff served by a staff member who is not a relevant individual) become aware that an individual is / has been involved in possible unregistered dealing, they should immediately report the incident to the compliance unit for investigation. RIs should seek proper legal advice if they have doubt about possible unregistered dealing of any staff member. Where there is a reasonable ground to believe that unregistered dealing has taken place, the RI should immediately stop such practice and report the matter to the HKMA in writing as soon as practicable.
- (d) RIs should ensure that staff members who are seeking registration with the HKMA are fully aware that they are not allowed to engage in any regulated function of a regulated activity before proper registration. It is also the responsibility of the supervisors of these staff members to ensure compliance with this requirement.
- (e) RIs should arrange regular training to staff on the implications of unregistered dealing and the importance of compliance with the relevant legal requirements as well as internal control procedures in this regard.

I would also like to take this opportunity to remind RIs of their obligation under section 20(4) of the BO. There should be proper procedures to ensure that the HKMA is notified of changes to any information of relevant individuals, including de-registration, within seven business days³. The notification should be made in writing for changes of information in relation to executive officers, and through the on-line submission mechanism of the electronic register for changes of information in relation to other relevant individuals.

If you have any questions on the content of this letter, please feel free to contact Ms Alice Lee at 2878-1603.

Yours faithfully,

Arthur Yuen
Executive Director
(Banking Supervision)

¹As defined in section 20(10) of the BO, "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. Under the same section of the BO, "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 arrangement with the institution relating to the regulated activity, other than work ordinarily performed by an accountant, a clerk or a cashier.

²The maximum penalties are a fine of \$1,000,000 and imprisonment for 2 years and, in the case of a continuing offence, a further fine of \$20,000 for every day during which the offence continues.

³Every director, every chief executive and every manager of an authorized institution which fails, without reasonable excuse, to comply with section 20(4) of the BO, commits an offence. The maximum penalties are a fine of \$400,000 and imprisonment for 2 years and, in the case of a continuing offence, a further fine of \$20,000 for every day during which the offence continues.

Encl. [List of RI](#) (Excel file, 22KB)

C.C. SFC (Attn: Mr Stephen Po, Senior Director,
Intermediaries and Investment Products Division)

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