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Hong Kong Licensed Corporations Alert

香港持牌法團快訊

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SFC's New Requirements on a Licensed Corporation's Reorganization

On June 2, 2017, the Hong Kong Securities and Futures Commission (SFC) issued a circular to licensed corporations on responsible officers (ROs) and substantial shareholders (Circular). The SFC found that there is an increasing number of licenses granted for corporations by the SFC through the purchase of a licensed corporation that has little or no business. This has added to the phenomenon of the holding of licensed corporations in Hong Kong by people who have not had sufficient experience in the securities industry in the past. At the same time, companies have to meet the requirements of having at least two ROs in order to be a licensed corporation. However, such ROs sometimes do not actually participate in the operation of the company and are only there to meet the requirement of the number of ROs. They do not carry out the functions of supervision and management, thus increasing the risk of compliance for the licensed corporation.

The SFC reminded the industry that a licensed corporation's ROs should have sufficient authority to supervise the business of regulated activity and it is not acceptable to hire ROs in name only. The SFC may consider the licensed corporation and the ROs are not fit and proper and they may be subject to disciplinary action. They may also have committed an offence of providing false or misleading information to the SFC in support of their application for approval as a responsible officer.

The assessment and vetting process for a new substantial shareholder application and a new licensed corporation application are at the same stringent level. The SFC will take into account a number of factors when assessing a new substantial shareholder application, including the proposed substantial shareholder's source of funding and if there are any potential changes to the licensed corporation's business plan and senior management. If licensed corporations and proposed new substantial

shareholders represent to the SFC that there will be no change to the licensed corporation's business plan and senior management, it is a continuous obligation for the licensed corporation to notify the SFC if changes occur later.



Higher Level of Accountability for Senior Management

The senior management of a licensed or registered person should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by a licensed corporation under General Principle 9 of the Code of Conduct for Persons Licensed by or Registered with the SFC (Code of Conduct).

The SFC has issued the Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management in order to articulate the SFC's view on the responsibility of the senior management.

Senior managements of a licensed corporation include directors, responsible officers (ROs), and Managers-In-Charge of Core Functions (MICs). "Core Functions" include overall management oversight, key business line, operational control and review, risk management, finance and accounting, information technology, compliance and anti-money laundering and counter-terrorist financing. For each Core Function there should be at least one individual appointed as its responsible MIC and the SFC expects that MICs of the overall management oversight function and the key business line function should be ROs. MICs of overall management oversight function and key business lines function, who are not yet ROs, should apply for approval to become ROs on or before October 16, 2017.

There are various existing codes and guidelines providing guidance on the responsibilities of senior management, including Paragraphs 9 and 14.1 of the Code of Conduct, the Internal Control Guidelines, the Guideline on Anti-Money Laundering and Counter-Terrorist Financing. Under Part IX of the SFO, ROs, a licensed person and all members of the senior management (even if they are not licensed) are regulated persons. The SFC may exercise its powers to sanction a regulated person if the person is guilty of misconduct or is not considered fit and proper to be a regulated person. Where a licensed corporation is guilty of misconduct due to the conduct of a person involved in the management of the business of the licensed corporation, then that person is also guilty of misconduct.

The level of responsibilities of the Board of a licensed corporation seems to be higher than that of other regulated persons as the SFC expressed explicitly that the Board of a licensed corporation has the ultimate responsibility for the conduct, operations and financial soundness of the corporation and any member of the Board (regardless of whether he or she plays an executive or non-executive role with respect to the business of the licensed corporation) has a duty to exercise independent judgement.

When applying for a license under s116(1) of the SFO, a corporation is required to provide information about its HR and organizational structure to show its capability of carrying on regulated activities competently. In addition, the corporation should submit an organizational chart depicting its management and governance structure, business and operational units and key human resources and their respective reporting lines. A new form, Supplement 8A – Manager-In-Charge of Core Function(s) has also been published by the SFC to facilitate such application.

Brief Updates on the Code of Conduct

The new edition of the Code of Conduct for Persons Licensed by or Registered with the SFC was published by the SFC on June 9, 2017. Below is a summary of some key amendments.



1. Standard clauses required in agreement with client

Under Clause 6.1 of the Code of Conduct, licensed or registered persons should enter into a written agreement (Client Agreement) with each client before services are provided to the client. Clause 6.2 sets out the minimum content of a Client Agreement. A new sub-clause (i) has been added under Clause 6.2, a standard clause is required to be included in a Client Agreement as follows:

"If we [the intermediary] solicit the sale of or recommend any financial product to you [the client], the financial product must be reasonably suitable for you having regard to your financial situation, investment experience and investment objectives. No other provision of this agreement or any other document we may ask you to sign and no statement we may ask you to make derogates from this clause."

2. No clauses to be inconsistent with the Code of Conduct

The SFC also states explicitly that a licensed or registered person should not include any clause, provision or term which is inconsistent with the Code of Conduct in the Client Agreement or any written document signed by the client at the request of a licensed or registered person.

Information in this alert is for reference only and should not be relied on as legal advice.