

**Bills Committee on
Securities and Futures Bill and Banking (Amendment) Bill 2000**

**Securities and Futures Bill
Part V – Licensing and exemption**

“Portability” of a Representative Licence

Introduction

At the Bills Committee meeting on 23 February 2001, Members expressed the view that a representative licence granted to an individual under the Securities and Futures Bill (the “SF Bill”) should not be revoked if he carries on the same regulated activity for another licensed corporation. This paper explains in greater detail the arrangements prescribed in the SF Bill. We envisage that in most cases, a representative licence is de-facto “portable” but approval for change in employment, i.e. transfer of accreditation, is required to protect investors.

Representative licence and accreditation

2. As far as an individual market practitioner is concerned, there are two main types of approval by the Securities and Futures Commission (SFC) under the SF Bill, namely approval for a representative licence under clause 119 and approval for, and transfer thereafter of, accreditation under clause 121. Representative licence involves an assessment by the SFC of whether an individual is a fit and proper person to be licensed to carry on a regulated activity, in accordance with the criteria outlined in clause 128¹. Accreditation concerns employment of a licensed representative by a licensed corporation to carry on a regulated activity. An individual can only carry on a regulated activity if he or she has been granted a representative licence in respect of, and is carrying on, the regulated activity for a licensed corporation to which he or she is accredited.

¹ The SFC will take into consideration a number of factors in determining whether a person is fit and proper, such as education, qualifications, experience, competency, reputation, character, reliability, financial integrity, etc.

Representative licence

3. In most cases, an individual will not lose his/her representative licence only by reason that he or she works for another licensed corporation. However, as the representative licence is granted for enabling them to carry on a regulated activity, it will be deemed to be revoked if they cease to be accredited to a licensed corporation (i.e. they cease to be employed to carry on a regulated activity) and have failed to apply for a transfer to accreditation to another licensed corporation within 90 days of the cessation.

4. This notwithstanding, in processing an application for licence from an individual whose representative licence has been deemed revoked in the circumstances described in paragraph 3 but it is less than 6 months since they left their previous job, the SFC may within a short time issue a provisional licence under clause 119, pending completion of all information verification work. The SFC will also have regard to the applicant's past experience in considering the application. Given the rapid development in the securities and futures market, the 6-month "expiry" period is considered justified lest the individual is not up-to-date with the latest market practice. (For the same reason, all licensed representatives have to meet certain continuous professional training requirements to demonstrate that they remain fit and proper to be licensed.)

Accreditation

5. An individual is required to seek the approval of the SFC regarding the licensed corporation on behalf of which he or she is to carry on a regulated activity (for which he or she is licensed). As set out in clause 121, the SFC will grant the approval if it is satisfied that the licensed representative is competent to carry on his/her duties to the requisite standard for or on behalf of the concerned licensed corporation. As a licensed representative has already been assessed by the SFC as fit and proper in respect of the regulated activity, the accreditation approval is normally a straightforward process involving a simple inquiry as to the reason(s) for which the licensed representative has left his last employment.

6. In fact, 95% of the applications for transfer of accreditation received in the last two years were straightforward without any complication. Where the applicant is going to a new job and there is no material change in duties and the SFC does not have any reason to suspect misconduct, then the SFC will not undertake a full vetting of the applicant and approval of the transfer will be granted as a matter of course.

7. In addition, nearly half of the applications received in the last two years were approved within 10 business days. Generally applications would have been approved sooner had all relevant documentation requirements be met upon submission of application. The SFC is currently reviewing its licensing process and with the advent of information technology, the aim is to shorten the approval time to 5 working days. We do not think that there are any unnecessary impediments to a transfer of employment.

Need for accreditation

8. We will explain below why accreditation to a licensed corporation is a necessary condition for granting a representative licence to the individual concerned.

New responsibilities

9. Where a person is taking up a new job involving materially different responsibilities, their past experience as a registrant is not necessarily an indication that they are fit and proper for the new work. Indeed it will not always be clear that a transfer of accreditation is sufficient – the change in responsibility may require a change of registration. For example, a person who is registered for Type 4 activity (advising on securities) may wish to move to an area that involves advising that also looks at strategies for acquiring securities and they may require a Type 6 approval (advising on corporate finance). The dividing line is a question calling for judgement. Similarly, under the SF Bill, a person originally licensed for giving investment advice may need to be licensed for dealing in securities if their new job requires him to market securities rather than advising person on securities. The judgement has important implications for investor protection and it is not acceptable to expose investors to risk on the basis that the SFC could “fix” things after the event. The SFC is best placed to make an objective judgement and ensure proper investor protection.

Suspected misconduct

10. There are cases where licensed representatives have left their former employment because of suspected misconduct (e.g. misappropriation of company or client assets). In other words, their fitness and properness are under question. Where the SFC knows about the suspected misconduct it may decide to inquire into it with a view to taking possible disciplinary action. An inquiry and disciplinary action may take some time to complete. In some cases, the SFC will judge that the risks are such that a transfer should not be approved pending the outcome of the inquiry.

11. If the inquiry is at a preliminary stage or if the outcome of the inquiry is unlikely to result in a revocation or a prolonged suspension of the representative's licence, the SFC will normally approve the transfer of the representative's accreditation. Under certain circumstances, the SFC may, as a condition of the approval, require a letter of support and acknowledgement from the prospective employer.

12. Unfortunately, there have been several cases in which a representative has been asked to leave under a suspicion of misconduct and where the SFC has not been told of the suspicion and goes ahead and approves the change of accreditation. That is not satisfactory from an investor protection point of view, but the risk is at least diminished by the accreditation process. This is not a problem unique to Hong Kong. The same problem has been observed in empirical studies in the U.S. As a matter of investor protection, the accreditation process involves a simple inquiry as to the circumstances in which a person has left an employer.

Licence conditions

13. A representative licence granted under clause 119 is subject to such reasonable conditions as the SFC may impose having regard to, for example, whether the licensed representative has a record of past misconduct or lacks the necessary qualification or experience to perform the whole range of a regulated activity. In respect of the latter, for instance, a licence granted to a corporate finance adviser very often attaches specific conditions limiting the circumstances in which he can give advice. The conditions may include the specific types of corporate finance matters on which he or she is allowed to advise, whether he may tender advice as the sole adviser, etc. Sometimes the conditions are specific to the individual and sometimes they are attached to the individual because of the circumstances of the corporation for which he works. In the circumstances, the SFC has to, through the accreditation approval process, ensure that the relevant licensed corporation as the new employer is aware of its prospective employee's licensing conditions and that the licensed corporation is to put in place suitable internal control accordingly.

14. A change in employment may lead the SFC to conclude that a person's licence should be subject to new conditions. For example, a person may be competent to be licensed for Type 6 activity (advising on corporate finance), when working for a large firm where there are many others who are qualified in the area. However, that same person, working in a small firm without the support of others who have relevant experience, may be subject to a

condition that he should not be a sole adviser on a Takeovers Code matter. That is particularly so where he is brought into the firm as a replacement and we must reconsider the terms of the firm's licence, imposing on the firm as a whole a condition. Again, a judgement is required and the SFC is best placed to make that objective judgement.

15. As mentioned above, most of the applications for transfer of accreditation are straightforward and approved very quickly. In 1999 and 2000, 1 660 and 2 241 applications were received by the SFC respectively. Of these, 96 cases in 1999 and 122 cases in 2000 were subject to on-going inquiries regarding whether the applicant was fit and proper.

Procedural safeguard and appeal

16. Clause 137 provides, inter alia, that the SFC must give a licensed representative applying for a transfer of accreditation a reasonable opportunity of being heard before making its final decision. If the licensed representative is aggrieved by the decision of the SFC to refuse his application, he can lodge an appeal with the Securities and Futures Appeals Tribunal.

International experience

The UK

17. The Financial Services Authority (FSA) has yet to make rules on the matter of accreditation. Our understanding is that the FSA is likely to continue the practice of the Securities and Futures Authority and require the licensed representatives to seek FSA's consent to their changes in accreditation.

The US

18. In the US, representatives of broker/dealer through their employers need to notify the National Association of Securities Dealers for changes of employment. Employers and/or members of the investing public could access to the disciplinary records of the employees. The onus of ensuring employees are fit and proper therefore rests with individual licensed corporations. Employers have strong incentives to ensure their employees are in fact fit and proper, lest they be sued in the event of misconduct.

Conclusion

19. The representative licence of an individual will not be revoked only by reason of his working for another licensed corporation. The mechanism to approve accreditation is required for protection of investors. The process itself is straightforward in most instances. In the small number of cases where licensed representatives are not allowed to carry on a regulated activity when they change employment, the major reasons are that they have changed to jobs requiring them to carry on new responsibilities for which they are not qualified, or that they have been involved in misconduct in their previous employment which casts doubt on whether they remain fit and proper to conduct the regulated activity. We take the view that this approval mechanism, which has been working well for years, should continue.

Financial Services Bureau
28 February 2001