

LEGISLATIVE COUNCIL BRIEF

Securities and Futures Ordinance (Cap. 571)

SECURITIES AND FUTURES (ASSOCIATED ENTITIES - NOTICE) RULES

INTRODUCTION

Pursuant to section 397 of the Securities and Futures Ordinance (Cap. 571) (the SFO), the Securities and Futures Commission (the SFC) has made the Securities and Futures (Associated Entities - Notice) Rules (the Rules) at the **Annex**.

BACKGROUND

The SFO

2. The SFO was enacted in March 2002. It consolidates and modernizes ten existing ordinances governing the securities and futures markets into a composite piece of legislation to keep the regulatory regime on a par with international standards and practices. For effective regulation, the SFO provides flexibility in addressing changing market practices and global conditions by empowering the Chief Executive in Council, the Financial Secretary, the Chief Justice and the SFC to prescribe detailed and technical requirements as necessary by way of subsidiary legislation, to supplement the regulatory framework laid down under the primary legislation.

3. On 22 February 2002, the House Committee of the Legislative Council established the Subcommittee on Draft Subsidiary Legislation to be made under the Securities and Futures Ordinance (the Subcommittee) to study the subsidiary legislation necessary for commencing the SFO. From March 2002 to October 2002, the Subcommittee held 12 meetings and considered a total of 37 sets of draft subsidiary legislation, including the vires to make them.

THE PROPOSALS

Major policy considerations

4. There is an apparent regulatory gap under the existing legislation in that a securities dealer can discharge his obligation to his client in respect of that client's securities held in Hong Kong by registering those securities in the name of his nominee. To bring the nominee into the regulatory net for better investor protection, section 164 of the SFO prescribes the types of persons that are allowed to receive or hold in Hong Kong client assets; i.e. the intermediary, its associated entity (defined to mean a company that is in a controlling entity relationship¹ with an intermediary and receives or holds in Hong Kong client assets of the intermediary) and a person falling within the definition of "excluded person" which includes an authorized financial institution. The SFO then imposes direct regulation over an associated entity. By way of illustration, the Client Securities Rules and the Client Money Rules made by the SFC respectively under sections 148 and 149 of the SFO have direct application to an associated entity. Section 165 of the SFO further requires a person to notify the SFC when it becomes or ceases to be an associated entity. The Rules supplement section 165 by prescribing the particulars that have to be submitted to the SFC together with the notification of becoming or ceasing to be an associated entity.

THE RULES

5. Clause 2 of the Rules contains interpretation provisions that apply throughout the Rules.

6. Clause 3 prescribes the information to be submitted to the SFC when a corporation becomes an associated entity, including information for enabling the SFC to get hold of basic information of the corporation and its key personnel; and for a corporation which is not an authorized financial institution, also information about the accounts for holding client assets of the intermediary and existence of matters that might render it insolvent or leading to the appointment of a liquidator.

7. Clause 4 prescribes the information to be submitted to the SFC when a corporation ceases to be an associated entity, including the facts that gave rise to its ceasing to be an associated entity; and for a corporation which

¹ A person who controls 20% of the voting power of another company is a controlling entity.

is itself neither an intermediary nor an authorized financial institution, also whether all client assets of the relevant intermediary have been properly accounted for and disposed of, and if not, details of those clients assets which have not been so dealt with.

PUBLIC CONSULTATION

8. The SFC released a consultation document and an exposure draft of the Rules on 22 March 2002 for comment by the public. A total of three submissions were received. While the submissions generally supported the exposure draft, the SFC amended the Rules to reflect the arrangements under the Securities and Futures (Licensing and Registration – Information) Rules). The SFC has also further particularized the types of information that must be reported.

9. A draft of the Rules was considered by the Subcommittee at its meeting held on 6 June 2002. Members of the Subcommittee expressed no major concerns but some drafting comments which have been accordingly reflected in the Rules.

FINANCIAL AND STAFFING IMPLICATIONS

10. There are no financial or staffing implications for the Government.

COMMENCEMENT DATE

11. The Rules will come into operation on the day appointed for the commencement of the SFO, together with other subsidiary legislation necessary for the commencement. We expect this to take place shortly, after completion of the negative vetting procedure through the Legislative Council and allowing the industry a reasonable period of time for making necessary adjustments with reference to the subsidiary legislation. We aim to announce the target commencement date by the end of 2002.

PUBLICITY

12. The Rules will be published in the Gazette on 6 December 2002.

The SFC will issue a press release on the same day.

ENQUIRIES

13. For any enquiries on this brief, please contact Mr. Chung Hing Hing of the Licensing Department of the SFC at 2842 7679 or Mr. Anthony Wood of the Legal Services Division of the SFC at 2840 9276.

The Securities and Futures Commission
6 December 2002

**SECURITIES AND FUTURES (ASSOCIATED ENTITIES -
NOTICE) RULES**

(Made by the Securities and Futures Commission under section 397(1)
of the Securities and Futures Ordinance (Cap. 571))

1. Commencement

These Rules shall come into operation on the day appointed for the commencement of the Securities and Futures Ordinance (Cap. 571).

2. Interpretation

(1) In these Rules, “CE number” (中央編號) means the central entity identification number assigned by the Commission to a licensed person or a registered institution which is shown, in relation to each licence or registration, on the register maintained under section 136 of the Ordinance.

(2) Where an associated entity that becomes or ceases to be such associated entity is an authorized financial institution, a requirement in these Rules for it to provide particulars to the Commission shall not be construed as a requirement to provide particulars relating to its business other than that of receiving or holding client assets of any intermediary of which it is an associated entity.

3. Particulars to be notified on becoming an associated entity

(1) For the purposes of section 165 of the Ordinance, the particulars required to be provided to the Commission in the event that a licensed corporation or a registered institution becomes an associated entity of an intermediary are –

- (a) its name and business name (if different);
 - (b) its CE number;
 - (c) the date it became an associated entity of the intermediary;
- and

(d) the name of the intermediary.

(2) For the purposes of section 165 of the Ordinance, the particulars required to be provided to the Commission in the event that a corporation other than a licensed corporation or a registered institution becomes an associated entity of an intermediary are –

- (a) its name and business name (if different);
- (b) the date and place of its incorporation;
- (c) the address of its registered office;
- (d) the address of its principal place of business in Hong Kong (if any);
- (e) its correspondence address;
- (f) its telephone and facsimile numbers, electronic mail address (if any) and web site address (if any);
- (g) the date it became an associated entity of the intermediary;
- (h) the name of the intermediary;
- (i) whether it has any executive officers and, if so, the following particulars of each of the executive officers –
 - (i) the name of the executive officer;
 - (ii) the Hong Kong identity card number of the executive officer or, if he is not the holder of such an identity card, the number, the name of the issuing agency and the date of expiry of his passport, travel or other document issued by a competent government agency providing proof of identity;
 - (iii) his residential address in Hong Kong (if any); and
 - (iv) his correspondence address;
- (j) the following particulars of each person who is its controlling entity –
 - (i) the name of the person;

- (ii) where the person is an individual –
 - (A) his Hong Kong identity card number or, if he is not the holder of such an identity card, the number, the name of the issuing agency and the date of expiry of his passport, travel or other document issued by a competent government agency providing proof of identity;
 - (B) his residential address in Hong Kong (if any); and
 - (C) his correspondence address; and
- (iii) where the person is a corporation –
 - (A) if it is registered under the Business Registration Ordinance (Cap. 310), its business registration number;
 - (B) the address of its principal place of business in Hong Kong (if any); and
 - (C) its correspondence address;
- (k) the address of each of the premises where books and records relating to client assets of the intermediary, which are received or held by it in Hong Kong, are kept;
- (l) the facts that gave rise to the corporation becoming an associated entity of the intermediary;
- (m) subject to subsection (3), whether it is aware of the existence of any matter that might render it insolvent or lead to the appointment of a liquidator; and
- (n) subject to subsection (3), the following particulars in respect of any bank account of it that holds, or that has been opened to hold, client assets of the intermediary that are received or held by it in Hong Kong –

- (i) the name of the bank with which the account is opened; and
- (ii) the number of the account.

(3) Where an associated entity that becomes such associated entity is an authorized financial institution, subsection (2)(m) and (n) do not apply to it.

4. Particulars to be notified on ceasing to be an associated entity

(1) For the purposes of section 165 of the Ordinance, the particulars required to be provided to the Commission in the event that a licensed corporation or a registered institution ceases to be an associated entity of an intermediary are –

- (a) its name and business name (if different);
- (b) its CE number;
- (c) the date it ceased to be an associated entity of the intermediary; and
- (d) the name of the intermediary.

(2) For the purposes of section 165 of the Ordinance, the particulars required to be provided to the Commission in the event that a corporation other than a licensed corporation or a registered institution ceases to be an associated entity of an intermediary are –

- (a) the date it ceased to be an associated entity of the intermediary;
- (b) the name of the intermediary;
- (c) whether all client assets of the intermediary that are received or held by it prior to its ceasing to be such associated entity have been fully accounted for and properly disposed of and, if not, the particulars of any such client assets of the intermediary that have not been fully accounted for and properly disposed of; and

(d) the facts that gave rise to the corporation ceasing to be an associated entity of the intermediary.

(3) Where an associated entity that ceases to be such associated entity is an authorized financial institution, subsection (2)(c) does not apply to it.



Andrew Len Tao **SHENG**
Chairman,
Securities and Futures Commission

2nd December, 2002

Explanatory Note

These Rules are made by the Securities and Futures Commission (“the Commission”) under section 397(1) of the Securities and Futures Ordinance (Cap. 571) (“the Ordinance”). They prescribe, for the purposes of section 165 of the Ordinance, the particulars that an associated entity of an intermediary must provide under that section of the Ordinance to the Commission by notice in writing when it becomes or ceases to be such associated entity.