

LEGISLATIVE COUNCIL BRIEF

Securities and Futures Ordinance (Cap. 571)

SECURITIES AND FUTURES (FINANCIAL RESOURCES) (AMENDMENT) RULES 2008

INTRODUCTION

Pursuant to sections 145 and 397 of the Securities and Futures Ordinance (“SFO”), the Securities and Futures Commission (the “SFC”), after consultation with the Financial Secretary, has made the Securities and Futures (Financial Resources) (Amendment) Rules 2008 (the “Amendment Rules”) at **Annex 1**. The Amendment Rules seek to amend the Securities and Futures (Financial Resources) Rules (the “FRR”) to require all licensed corporations to submit their financial returns to the SFC electronically.

BACKGROUND

2. Licensed corporations are required to submit financial returns to the SFC under the FRR. At present, they may elect to submit their returns (i) electronically through the FinNet, which is a closed financial industry network; (ii) in electronic form on a computer diskette; or (iii) in paper form.

3. Of the 800 licensed corporations required to submit monthly returns, about 60% submit returns on computer diskettes or in paper form

and these require manual processing by the SFC. Also, of the 500 licensed corporations required to submit half-yearly returns only, the vast majority are submitting them in paper form. The manual processing of the financial returns submitted in paper form, and to a lesser extent on a computer diskette, involves considerable resources and is prone to data entry errors and undue delays in the analysis of the returns. Furthermore, it is more time consuming for those licensed corporations submitting returns in paper form to prepare and amend their returns (as they have to perform arithmetic checking manually). Hence, it is desirable to mandate e-submission that supports straight through processing.

PROPOSAL AND JUSTIFICATIONS

4. The SFC proposes to amend the FRR to require all licensed corporations to submit their returns to the SFC electronically by means of an online communication system approved by the SFC. This proposal is beneficial to the industry as the built-in arithmetic checking function will help reduce clerical and data entry errors. The e-submission option also provides more flexibility to licensed corporations as they can prepare and amend the returns electronically at any time before the submission deadline.

5. This move to e-submission will bring our regime in line with other local and overseas regulators.

6. To facilitate e-submission, the SFC will allow electronic filing using the Internet as an additional option to FinNet whilst introducing additional measures to ensure security of transmission. For example, a

strong encryption technology will be introduced to ensure that the information on the returns is end-to-end encrypted, meaning that the information will be encrypted from the point the financial return is sent to the point when the return is received by the SFC.

7. Presently under the FRR, in order to sign their returns electronically, licensed corporations need to apply for their own e-certificates from the certification authorities. The Amendment Rules will provide for the signing of the financial returns submitted through the Internet by a licensed corporation attaching an e-certificate issued by the SFC via a certification authority recognized under the Electronic Transactions Ordinance. The new option alleviates the need of licensed corporations to apply for their own e-certificates and allows them to use any computer that has access to the Internet rather than a computer specified for use with FinNet.

PUBLIC CONSULTATION

8. The SFC released a consultation paper on the proposal to mandate e-submission of financial returns on 9 November 2007 for comments by the public (see **Annex 2**). Of the eight submissions received, only one respondent objected to the proposal without providing any explanation even though it was already submitting returns electronically under the present system. Most of the respondents only raised technical questions regarding the e-submission procedures. A copy of the consultation conclusions issued on 13 March 2008 is at **Annex 3**.

THE AMENDMENT RULES

9. The Amendment Rules amend the FRR to require all licensed corporations to submit their financial returns to the SFC electronically.

10. **Section 2** amends section 56 of the FRR to require a licensed corporation to submit a financial return to the SFC electronically by means of an online communication system approved by the SFC, and to sign the return by way of attachment to the return of an e-certificate.

11. **Section 3** amends section 58 of the FRR to require the SFC to issue directions and instructions for the use of the online communication system approved by it.

FINANCIAL AND STAFFING IMPLICATIONS

12. Additional costs will be incurred for issuing the e-certificates to designated officers of licensed corporations and for enhancing/ introducing other necessary IT measures. The costs will be absorbed by the SFC. There are no financial and staffing implications for the Government.

COMMENCEMENT DATE

13. The Amendment Rules will come into operation on 1 November 2008.

PUBLICITY

14. The Amendment Rules will be published in the Gazette on 25 April 2008. The SFC will issue a press release on the same day.

ENQUIRIES

15. For any enquiries on this brief, please contact Mrs. Yvonne Mok of the Intermediaries Supervision Department of the SFC at 2842-7638.

Securities and Futures Commission

23 April 2008

SECURITIES AND FUTURES (FINANCIAL RESOURCES) (AMENDMENT) RULES 2008

(Made by the Securities and Futures Commission under sections 145 and 397 of the Securities and Futures Ordinance (Cap. 571) after consultation with the Financial Secretary)

1. Commencement

These Rules shall come into operation on 1 November 2008.

2. Licensed corporations to submit returns to Commission

(1) Section 56(1) of the Securities and Futures (Financial Resources) Rules (Cap. 571 sub. leg. N) is amended by repealing “in the manner specified in subsections (5) and (6)(*d*), (*e*) or (*f*) (as the case may be), no later than 3 weeks after the end of the month concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which” and substituting “, in the manner specified in subsection (5) and no later than 3 weeks after the end of the month concerned, a return which is in the form specified by the Commission under section 402 of the Ordinance and signed in the manner specified in subsection (6), and”.

(2) Section 56(2) and (3) is amended by repealing “in the manner specified in subsections (5) and (6)(*d*), (*e*) or (*f*) (as the case may be), no later than 3 weeks after the end of the period concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which” and substituting “, in the manner specified in subsection (5) and no later than 3 weeks after the end of the period concerned, a return which is in the form specified by the Commission under section 402 of the Ordinance and signed in the manner specified in subsection (6), and”.

(3) Section 56(5) is repealed and the following substituted –

“(5) For the purposes of this section, a licensed corporation shall submit a return referred to in this section to the Commission electronically by means of an online communication system approved by the Commission under section 58(7) for the purposes of this subsection.”.

(4) Section 56(6) is repealed and the following substituted –

“(6) For the purposes of this section –

(a) a return referred to in this section shall be signed on behalf of the licensed corporation concerned by a responsible officer of the licensed corporation or another officer of the licensed corporation approved by the Commission under section 58(5)(e) for the purposes of this section, by way of attachment to the return of the digital signature or electronic signature of the responsible officer or other officer; and

(b) the signature referred to in paragraph (a) shall –

(i) in the case of a digital signature, be supported by a recognized certificate, generated within the validity of that certificate and used in accordance with the terms of that certificate; or

(ii) in the case of an electronic signature, be authenticated in accordance with such directions

and instructions for the use of the online communication system concerned as are published by the Commission under section 58(8).”.

(5) Section 56(6A) is amended by repealing “(6)(d)(i)(A)” and substituting “(6)(b)(i)”.

(6) Section 56(7) is amended by adding –
 ““electronic signature” (電子簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap. 553);”.

3. Approvals

(1) Section 58(5)(e) is amended by repealing “56(5)” and substituting “56(6)”.

(2) Section 58(7) is amended –

(a) by repealing “56(6)(a)” and substituting “56(5)”;

(b) by repealing “a secure online communication network” and substituting “an online communication system”.

(3) Section 58(8) is amended –

(a) by repealing “a communication network” and substituting “an online communication system”;

(b) by repealing “details of the network” and substituting “directions and instructions for the use of that system”.

Martin WHEATLEY
 Chief Executive Officer,
 Securities and Futures Commission

21 April 2008

Explanatory Note

These Rules amend the Securities and Futures (Financial Resources) Rules (Cap. 571 sub. leg. N) (“the principal Rules”) to require all licensed corporations to submit their financial returns to the Securities and Futures Commission (“the Commission”) electronically.

2. Section 2 amends section 56 of the principal Rules to require a licensed corporation to submit a financial return to the Commission electronically by means of an online communication system approved by the Commission, and to sign the return by way of attachment to the return of the digital signature or electronic signature of its responsible officer or of another officer approved by the Commission for the purpose.

3. Section 3 amends section 58 of the principal Rules to require the Commission to issue directions and instructions for the use of the online communication system approved by it.



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Annex 2

Consultation Paper on Electronic Submission of Financial Returns

**HONG KONG
NOVEMBER 2007**

Introduction

1. This consultation document invites public comments on proposed amendments to the Securities and Futures (Financial Resources) Rules (“FRR”), as set out in Appendix 1.
2. The proposed amendments are to require all licensed corporations to submit their financial returns under the FRR electronically by means of an online communication system.
3. To facilitate such electronic submission and as an alternative network option to FinNet, the SFC proposes to allow electronic filing using the Internet whilst introducing additional measures to ensure security of transmission and to provide for the signing of the financial return by attaching a SFC issued e-certificate (similar to the e-certificate of Hong Kong Post and Digi-Sign) which will be issued free to applicants.
4. The SFC has used the FinNet communication network to send copies of this consultation document to all licensed corporations. In addition, the consultation document is available on the SFC’s Internet website at <http://www.sfc.hk>.
5. The SFC invites interested parties to submit written comments on the proposed amendments by no later than 10 December 2007. Any person wishing to comment should provide details of any organization whose views they represent. In addition, persons suggesting alternative approaches are encouraged to submit proposed text to be incorporated into the FRR.
6. Please note that the names of the commentators and the contents of their submissions may be published on the SFC website and in other documents to be published by the SFC. In this connection, please read the Personal Information Collection Statement attached to this consultation document.
7. You may not wish your name to be published by the SFC. If this is the case, please state that you wish your name to be withheld from publication when you make your submission.
8. Comments may be submitted as follows:

By mail to: SFC (e-FRRR)
8/F, Chater House
8 Connaught Road Central
Hong Kong

Attn: Intermediaries Supervision Department

By fax to: (852) 2523-4598

By e-mail submission to: e-FRRR@sfc.hk

I. Background

9. Presently, a licensed corporation may elect to submit its financial return
 - (a) electronically, by means of a secure online communication network approved by the Commission (i.e. FinNet operated by the SFC), whilst
 - (i) either signing the return by attaching its digital signature supported by an e-certificate; or
 - (ii) providing a signed copy of the return in paper form;
 - (b) in electronic form on a floppy disk, accompanied by a signed copy of the return in paper form; or
 - (c) in paper form, submitting the signed original of the return.
10. Over the years, the SFC has made continuous and conscious effort in trying to persuade licensed corporations to adopt electronic submission that supports straight through processing (thereafter referred to as “**e-submission**”). Of the 835 licensed corporations that submitted monthly financial returns for July 2007-
 - (a) 70% submitted their returns electronically with -
 - (i) 21% via FinNet with an e-certificate;
 - (ii) 19% via FinNet without an e-certificate;
 - (iii) 30% by means of floppy disks; and
 - (b) 30% submitted in paper form.

Of the 526 licensed corporations that submitted half-yearly financial returns for June 2007, the majority (69%) submitted them in paper form.

Merits of electronic submission of financial returns

11. Our aim is to move all licensed corporations to e-submit their returns to the SFC. There are a number of reasons why it is considered beneficial to adopt e-submission:
 - (a) help reduce clerical errors when completing the returns by ensuring that all licensed corporations can benefit from the existing arithmetic checking function built into the soft copy of the returns;
 - (b) provide more flexibility to licensed corporations when they deliver their financial returns to the SFC; and
 - (c) avoid input errors and minimize undue delays in the analysis of financial returns by the Commission caused by manual processing of the financial returns submitted in paper form, and to a lesser extent, on a floppy disk.

12. On that basis, we believe it should be beneficial to mandate e-submission especially in the light of the popularity of e-submission in other local and overseas financial sectors.

Organization	E-submission arrangement
Hong Kong Monetary Authority	Through FinNet signed by an e-certificate
Mandatory Provident Fund Schemes Authority (HK)	Through private network
Monetary Authority of Singapore	Through private network
Securities and Exchange Commission (US)	Through Internet
China Securities Regulatory Commission (PRC)	Through Internet

II. Proposals to facilitate e-submission

13. Based on our observations and discussions with selected firms, we understand that some of the licensed corporations have not adopted e-submission for a variety of reasons. Some find it inconvenient to apply for an e-certificate¹ or attach signatures supported by this e-certificate. Some are also concerned with the following factors:
- (a) submission via FinNet must be done from designated computers which may not be readily accessible by the officers signing the return; and
 - (b) the risk of assigning an officer the firm’s e-certificate which can bind the firm for unlimited amount and for whatever purpose.
14. In the light of the concerns of the licensed corporations, we propose to introduce the following measures to facilitate e-submission of returns:

(a) Signing of returns using a digital certificate issued by the SFC

First, we propose to introduce an additional option for authentication and non-repudiation purposes. One of the options considered is for the SFC to issue a private label digital certificate (“**private certificate**”).

Instead of requiring licensed corporations to approach certification authorities individually, private certificates will be issued by the SFC in the name of persons nominated by the respective licensed corporations (via a certification authority recognized under the Electronic Transactions Ordinance). This will simplify the

¹ At present, there are only 2 recognized certification authorities in Hong Kong. Of the licensed corporations that attach digital signature to their returns, all the signatures are supported by Hong Kong Post.

application procedure required. A licensed corporation will still be signing the return electronically by attaching a signature supported by a private certificate.

(b) Submitting returns via Internet as an additional network option to FinNet

Second, we propose to allow submission via either Internet or FinNet. This will mean that licensed corporations can choose to use designated computers for submission via FinNet or any corporate computers accessible to Internet.

Internet is a common channel used by other regulators for collection of returns. Technically, it is feasible for the SFC to accept e-submission via Internet. However, since Internet is a public network, to reduce the probability of information being tampered, lost or stolen during transmission, the SFC has considered implementing a number of additional security measures, having made reference to the standard adopted by the commercial sector and other government bodies.

III. Benefits of e-submission

15. The e-submission proposals will benefit the industry in the following ways:

(a) Convenient and easy to use

- The signing and submission procedures will be simplified. Licensed corporations will only need to advise the SFC of whom they would like to nominate for signing the returns, normally the responsible officers of the licensed corporations (this process has been in place for some years and is working well). Private certificates will be issued to the nominated persons. The private certificates will be valid for a number of years and can be renewed on-line over the Internet (by redirecting from the SFC's website to the certification authority's website).
- The private certificate will be stored in a portable token provided to each person nominated by the licensed corporations. Nominated persons will only need to perform a few simple steps to download the private certificate required for signing the returns (i.e. by plugging their token into the USB (Universal Serial Bus) port of their computers).

(b) Secure

- The private certificates can only be used by nominated persons for signing a financial return submitted by a licensed corporation. It cannot be used as authority to bind the licensed corporations in other ways.
- The private certificates will be PIN (Personal Identification Number) protected. A User ID and password will be assigned to the nominated persons for authentication by the SFC's in-house system called the Electronic Financial Resources Rules Returns System (“**e-FRRR system**”).

- To ensure security of transmission via Internet, a strong encryption technology will be introduced to ensure that the information on the returns is end-to-end encrypted, meaning that the information will be encrypted from the point the financial return is sent to the point when the return is received by the SFC. In particular, the following technical measures will be introduced:
 - Secure online session by using industry standard encryption (SSL) will be established between the licensed corporation's computer and the SFC's eFRRR system host at the time of user log-in; and
 - File level encryption will also be applied on the licensed corporation's returns automatically before they leave the firm's computer and the returns will only get decrypted on the SFC's designated machine by using the authorized private key.

It will not be necessary for the SFC to install a new system program on a user's computer. In addition, the following administrative measures will be implemented:

- Checking will be built into the SFC's eFRRR system to guard against unauthorized access. The relevant password will be revoked after several unsuccessful attempts to gain access to the SFC's system;
- System logs will be kept to record access and transaction history for control and audit purposes; and
- Information security policy and system operational procedures will be applied by the SFC to govern the system security control over the eFRRR system.

A graph showing the proposed network for e-submission is enclosed at Appendix 2.

(c) Flexible

- Licensed corporations can choose to submit their returns via Internet or FinNet and sign the returns by attaching an e-certificate issued by a certification authority, e.g. Hong Kong Post or a SFC private certificate, depending on their preference and circumstances.
- Licensed corporations can also submit their returns to the SFC after office hours as long as the returns are submitted before midnight of day of the submission deadline.
- For licensed corporations that nominate one person for signing the financial returns for different licensed corporations within the same group, they may apply for a special token to be issued to the nominated person so that he could operate with just one token instead of different tokens for different firms and sign the returns for several companies within a group by using the private certificate stored in the token.

(d) Cost effective

- The SFC will bear the costs that are related to the provision of private certificates to persons nominated by licensed corporations.
- To perform e-submission of returns, licensed corporations only need to ensure that their computers meet some basic technical requirements. These are the ability to support the USB device, access to Internet and use of a Microsoft Excel program and a software called Java Virtual Machine².
- Training and assistance will be provided to licensed corporations by organizing seminars, giving demonstrations and operating a dedicated telephone hotline. Special arrangement may be made upon request to provide assistance on site. To help licensed corporations familiarize with e-submission, a trial run of the new mode of submission will also be conducted.

Cost-benefit analysis

16. As mentioned in paragraph 15 above, there are clear benefits to LCs when they adopt e-submission. For example, they can minimize their reporting errors by making use of the existing arithmetic checking function built into the soft copy of the returns and can enjoy the flexibility in delivering of returns. The cost to realize these benefits is however minimal as all they require is a computer that meets basic technical requirements. As computers are ubiquitous in the securities and futures sector, requiring LCs to submit their returns via computers is unlikely to significantly increase their IT cost. The benefits of adopting e-submission should therefore outweigh the possible additional costs to the industry.

IV. Market consultation

17. We have already conducted some market consultation on the proposals and given a demonstration to selected brokerage firms of different sizes and a number of industry associations. The feedback was generally positive with firms mainly asking for clarification or raising a few technical IT points peculiar to their circumstances. The firms were also satisfied with the measures to be introduced to ensure security of transmission over Internet. The major concern of the smaller firms was that they might not have the necessary IT resources and support for performing e-submission. We believe that the simplification of the signing and submission procedures and our dedicated IT support mentioned in paragraph 15 above should help address the smaller firms' concerns.
18. For loss of token, forgotten password and inability to submit returns electronically for some IT or power problem, licensed corporations could call the SFC hotline in the first instance to explain the problem and seek advice.

² Java Virtual Machine is a software component for reading the financial returns and can be easily downloaded from the Internet for free.

V. Proposed rule amendment

19. We propose to amend section 56 of the FRR to require all licensed corporations to e-submit their returns. This means licensed corporations must submit their returns via Internet or FinNet and sign the returns by attaching an e-certificate issued by a certification authority, e.g. Hong Kong Post, or a SFC private certificate.
20. The proposed changes to the relevant provisions are enclosed in Appendix 1. The exact wording is subject to the comments of the Law Draftsman. There are also consequential amendments to the declaration form of the financial return (being a form specified by the Commission under section 402 of the Securities and Futures Ordinance).
21. Implementation of the new proposals would be dependent on enacting the legislative amendments to the FRR and the introduction of the additional IT security measures as discussed above whilst allowing sufficient preparation time for the industry.

November 2007

**Proposed amendments to ss. 56 and 58 of the
Securities and Futures (Financial Resources) Rules**

S.56 Licensed corporations to submit returns to Commission

(1) Subject to subsection (4), a licensed corporation licensed for one or more of the following-

- (a) Type 1 regulated activity;
- (b) Type 2 regulated activity;
- (c) Type 3 regulated activity;
- (d) Type 4 regulated activity, and it is not subject to the specified licensing condition;
- (e) Type 5 regulated activity, and it is not subject to the specified licensing condition;
- (f) Type 6 regulated activity, and it is not subject to the specified licensing condition;
- (g) Type 7 regulated activity;
- (h) Type 8 regulated activity;
- (i) Type 9 regulated activity, and it is not subject to the specified licensing condition,

shall, in respect of each month at the end of which it remains licensed, submit to the Commission in the manner specified in subsections (5) and (6)(d), (e) or (f) (as the case may be), no later than 3 weeks after the end of the month concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which includes-

- (j) its liquid capital computation, as at the end of the month;
- (k) its required liquid capital computation, as at the end of the month;
- (l) a summary of bank loans, advances, credit facilities and other financial accommodation available to it, as at the end of the month;
- (m) an analysis of its margin clients, as at the end of the month;
- (n) an analysis of collateral received from its margin clients, as at the end of the month;
- (o) an analysis of its rolling balance cash clients, as at the end of the month;
- (p) an analysis of its profit and loss account;
- (q) an analysis of its client assets, as at the end of the month; and
- (r) where it is licensed for Type 3 regulated activity, an analysis of its foreign currency positions, as at the end of the month.

(2) Subject to subsection (4), a licensed corporation to which subsection (1) applies shall, in respect of each period of 3 months at the end of which it remains licensed, being such period in a year ending at the end of the month of March, June, September or December, respectively, submit to the Commission in the manner specified in subsections (5) and (6)(d), (e) or (f) (as the case may be), no later than 3 weeks after the end of the period concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which includes-

- (a) an analysis of its clientele, as at the end of the 3 month period;
- (b) an analysis of its proprietary derivative positions, as at the end of the 3 month period;
- (c) where it is licensed for Type 3 regulated activity, an analysis of its recognized counterparties, as at the end of the 3 month period; and
- (d) where it is licensed for Type 9 regulated activity, an analysis of the assets under its management, as at the end of the 3 month period.

(3) Subject to subsection (4), a licensed corporation which is licensed solely for one or more of the following-

- (a) Type 4 regulated activity;
- (b) Type 5 regulated activity;
- (c) Type 6 regulated activity;
- (d) Type 9 regulated activity,

and subject to the specified licensing condition, shall, in respect of each period of 6 months at the end of which it remains licensed, being such period in a year ending at the end of the month of June or December, respectively, submit to the Commission in the manner specified in subsections (5) and (6)(d), (e) or (f) (as the case may be), no later than 3 weeks after the end of the period concerned, a return, in the form specified by the Commission under section 402 of the Ordinance, which includes-

- (e) its liquid capital computation, as at the end of the 6 month period;
 - (f) its required liquid capital computation, as at the end of the 6 month period;
 - (g) an analysis of its profit and loss account;
 - (h) an analysis of its clientele, as at the end of the 6 month period; and
 - (i) where it is licensed for Type 9 regulated activity, an analysis of the assets under its management, as at the end of the 6 month period.
- (4) A licensed corporation may elect to submit the return required under-
- (a) subsection (1), in respect of periods of not less than 28 days but not more than 35 days, each ending not more than 7 days before or after the end of a month;
 - (b) subsection (2), in respect of periods of 3 months each ending not more than 7 days before or after the end of March, June, September or December in a year;
 - (c) subsection (3), in respect of periods of 6 months each ending not more than 7 days before or after the end of June or December in a year,

determined by it on a basis according to which the ending date of each period so determined is predictable, and where it so elects and submits the return concerned, it shall be deemed to have submitted the return concerned in respect of the period required under subsection (1), (2) or (3) (as the case may be).

(5) A return referred to in this section shall be signed on behalf of the licensed corporation concerned in the manner prescribed in subsection (6) by a responsible officer or another officer of the licensed corporation approved by the Commission under section 58(5)(e) for the purposes of this section.

(6) A licensed corporation shall submit a return referred to in this section to the Commission -

- (a) electronically, by means of an online communication system approved by the Commission under section 58(7) for the purposes of this paragraph;
- (b) duly signed on behalf of the licensed corporation concerned by way of attachment to the return of the digital signature or electronic signature of the responsible officer or other officer of the licensed corporation approved under subsection (5); and
- (c) the signature referred to in paragraph (b) shall –
 - (i) in the case of a digital signature, be supported by a recognized certificate, generated within the validity of that certificate and used in accordance with the terms of that certificate; or
 - (ii) in the case of an electronic signature, be authenticated in accordance with such directions and instructions as are published by the Commission under section 58(8).

~~(6) A licensed corporation may elect to submit a return referred to in this section to the Commission-~~

- ~~(a) electronically, by means of a secure online communication network approved by the Commission under section 58(7) for the purposes of this paragraph;~~

~~(b) in electronic form on a floppy disk, delivered by hand or by post to the Commission; or~~

~~(c) in paper form, delivered by hand or by post to the Commission,~~

~~and-~~

~~(d) where it submits the return in accordance with paragraph (a)-~~

~~(i) the return shall be signed by way of attachment to the return of the digital signature of the licensed corporation, and the digital signature shall be-~~

~~(A) supported by a recognized certificate;~~

~~(B) generated within the validity of that certificate; and~~

~~(C) used in accordance with the terms of that certificate; or~~

~~(ii) if the return is not signed as provided for in subparagraph (i), it shall also submit a signed copy of the return in paper form, delivered by hand or by post to the Commission;~~

~~(e) where it submits the return in accordance with paragraph (b), the floppy disk shall be accompanied by a signed copy of the return in paper form; or~~

~~(f) where it submits the return in accordance with paragraph (c), the signed original of the return shall be submitted.~~

(6A) For the purposes of subsection ~~(6)(c)(i)-(6)(d)(i)(A)~~, a digital signature is taken to be supported by a recognized certificate if it is taken to be supported by that certificate under section 2(2) of the Electronic Transactions Ordinance (Cap 553).

(7) In this section-

"digital signature" (數碼簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap 553);

"electronic signature" (電子簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap 553);

"recognized certificate" (認可證書) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap 553);

"rolling balance cash client" (滾存結餘現金客戶) means a client of a licensed corporation in respect of whom the amounts receivable from, and amounts payable to, him by the licensed corporation arising from the purchase and sale of securities on a cash-against-delivery basis by the licensed corporation for him may be set-off by the licensed corporation under section 21(3);

"within the validity of that certificate" (在該證書的有效期內) has the meaning assigned to it by section 6(2) of the Electronic Transactions Ordinance (Cap 553).

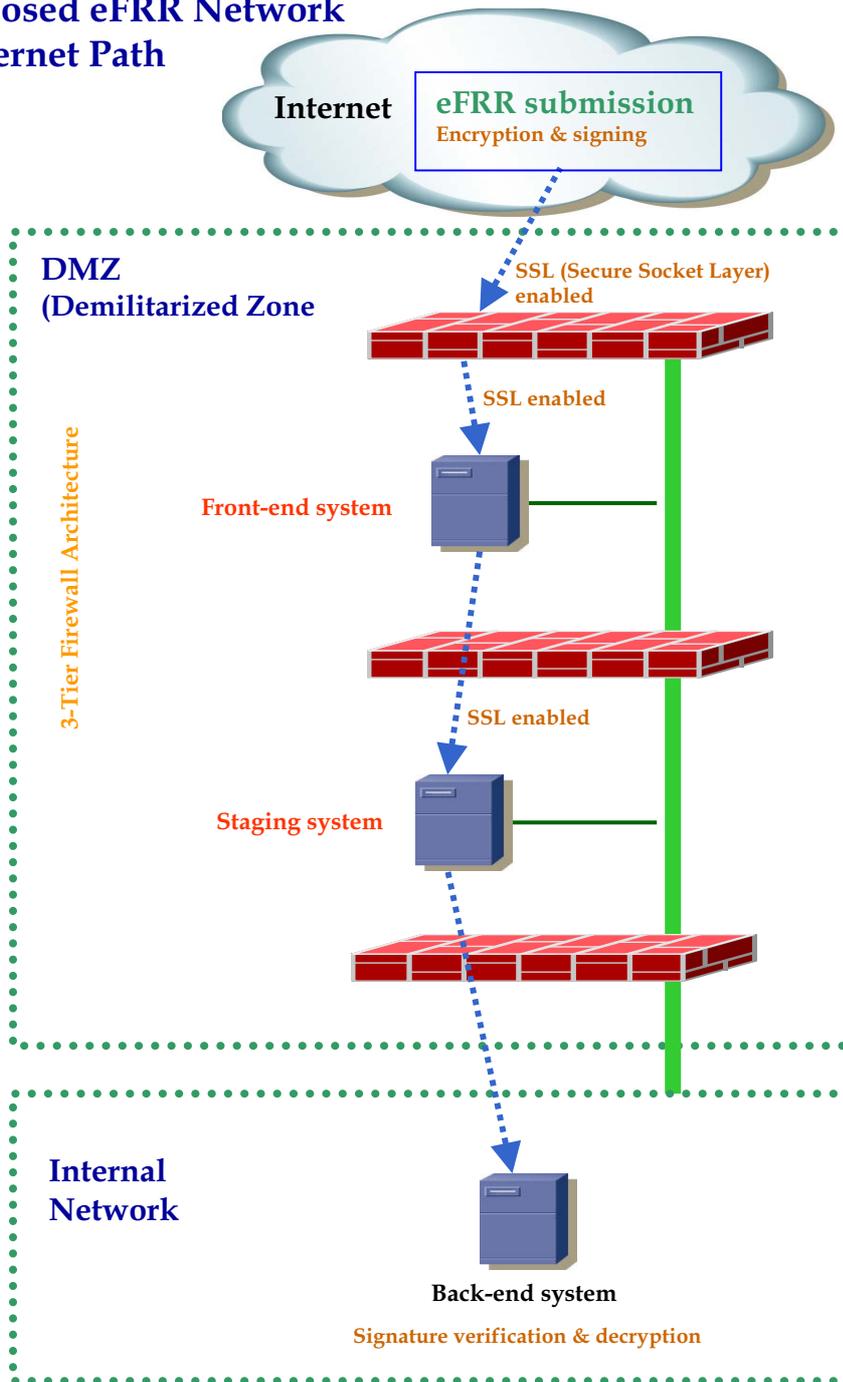
58 Approvals

(1) to (6) No change.

(7) The Commission may, for the purposes of section 56(6)(a), approve an secure online communication network system.

(8) Where the Commission approves a communication ~~network~~ system under subsection (7), it shall as soon as reasonably practicable publish details of the network system, and directions and instructions for the use of that system, including approved authentication system and protocol, in such manner as it considers appropriate.

**Proposed eFRR Network
- Internet Path**





SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Annex 3

Consultation Conclusions on Electronic Submission of Financial Returns

**HONG KONG
MARCH 2008**

INTRODUCTION

1. The Securities and Futures Commission issued a Consultation Paper on “Electronic Submission of Financial Returns” in November 2007 inviting comments on our proposal of amending the Securities and Futures (Financial Resources) Rules (“FRR”) to require all licensed corporations to submit their financial returns electronically. The consultation paper also sets out our proposals to facilitate e-submission such as by using private label digital certificates (“private certificates”) issued by a recognized certification authority for submission via Internet. The consultation period ended on 10 December 2007. In total, we have received eight written submissions. Six of the submissions were from licensed corporations/ groups of licensed corporations, one was from a law firm and another one was from the Hong Kong Law Society.
2. Four out of eight respondents stated that they were in support of the proposal or commented that the proposal was beneficial to the industry. Only one respondent objected to the proposal without providing any explanation even though it was already submitting financial returns electronically under the present system. Most respondents mainly raised technical questions regarding the e-submission procedures. The major comments of the respondents and the Commission’s responses are summarized below.

MAJOR COMMENTS AND THE COMMISSION’S RESPONSES

I. Renewal of private certificates and rejection of public certificates

Comments

3. One respondent questioned whether the renewal procedure is necessary for the private certificates if the signers of the returns are still the same. He also suggested the Commission to reject the public certificate issued by the Hong Kong Post as it is not widely accepted.

Commission’s responses

4. To follow the market best practices amongst certification authorities, licensed corporations should renew the private certificates at regular intervals, even if the signers have remained the same. The detailed private certificate application, renewal and cancellation procedures would be set out in a set of IT directions/ instructions to be published in due course.

Since some licensed corporations are currently using the public certificates issued by the Hong Kong Post when submitting their financial returns via FinNet, we intend to retain this option for the existing users.

Comments

5. A respondent was concerned whether the Commission’s hotline would be able to provide adequate support to the industry regarding forgotten password, loss of

token and private certificate application, cancellation and renewal etc. Another respondent also enquired about the detailed system and hardware requirements necessary for e-submission.

Commission's responses

6. For some years, the Commission's IT hotline has been assisting licensed corporations with their e-submission of financial returns via FinNet using the public certificate issued by the Hong Kong Post. The hotline would continue to provide necessary support and assistance to the licensed corporations after the introduction of the proposed requirement.
7. For e-submission of returns, licensed corporations only need to ensure that their computers meet some basic technical requirements. More details regarding the system and hardware requirements would be provided in the IT directions/instructions to be issued by the Commission.

Comments

8. A respondent requested that at least two private certificates should be issued per licensed corporation and a list showing the private certificate holders be made available via the Internet to the licensed corporation concerned.

Commission's responses

9. The Commission has always intended to issue two private certificates to each licensed corporation. In addition, licensed corporations may apply to the Commission for more certificates with reasons. Under the existing Electronic Financial Resources Rules Returns System ("e-FRRR system"), licensed corporations are already allowed to maintain their own list of e-certificate holders. This function would still be available after the implementation of the additional options for e-submission.

II. Failure to e-submit financial returns

Comments

10. Two respondents proposed that paper form submission should be allowed when e-submission is not possible under specific exceptional situations.

Commission's responses

11. Licensed corporations should report any such problems to the Commission's hotline immediately and based on the circumstances of each case, the Commission would adopt a pragmatic and flexible approach in determining the actions to be taken.

III. Other IT or security related issues

Comments

12. Three respondents requested an acknowledgement of receipt of the financial returns be issued to the licensed corporations and two of them also suggested the submission be time-stamped.
13. A respondent proposed that the e-FRRR system should be able to store historical submissions, print past and present submissions, maintain standing data and save half completed returns.

Commission's responses

14. Under the proposed e-FRRR system, an acknowledgement receipt showing the date and time of receiving the return will be automatically generated.
15. For security reasons, the proposed e-FRRR system has been designed not to allow online access facility for past submissions. However, in case of need, they could request the Commission on an ad-hoc basis to retrieve any of their returns. Also, as the financial return is in the form of an offline Microsoft Excel spreadsheet, licensed corporations could save the returns offline at any time.

Comments

16. Two respondents suggested that a hierarchy of access controls be structured into the e-FRRR system. One of them proposed that there should be one level of access for those inputting data and another level of access for the nominated persons to sign the returns.
17. A respondent asked what security measures would be put in place to ensure that submission via the Internet is performed by the nominated person.
18. Another respondent enquired about the legal or contractual obligations if the security measures are being compromised.

Commission's responses

19. The existing e-FRRR system already provides for two levels of access control, i.e. administration of system and submission of returns and this feature will remain in the proposed system. For internal control purposes, licensed corporations are expected to segregate duties over offline return preparation and online return submission.
20. The Commission will only grant the e-FRRR system login password and the PIN-protected private certificates to those persons nominated by the licensed corporation. Thus they would be the only persons who could sign and submit the returns on behalf of the licensed corporation.

21. Internet filing is considered safe by industry standard with all the security measures intended to be put in place by the Commission. However, if individual firms remain concerned, they still have the option of submitting their returns via the private network, i.e. the FinNet.

TIMING

22. The proposed amendments to the FRR are enclosed in Appendix 1. The amendments will be introduced into the Legislative Council for negative vetting as soon as practicable. Assuming that the legislative process runs smoothly, the Commission would start to provide training to licensed corporations and allow for testing of the new system in the third quarter of 2008 and roll out the new system in the fourth quarter of 2008.

FINAL NOTE

23. The Commission would like to thank all industry participants and other interested parties who have made constructive suggestions and comments in response to the Consultation Paper.

Proposed amendments to ss. 56 and 58 of the Securities and Futures (Financial Resources) Rules

S.56 Licensed corporations to submit returns to Commission

(1) Subject to subsection (4), a licensed corporation licensed for one or more of the following-

- (a) Type 1 regulated activity;
- (b) Type 2 regulated activity;
- (c) Type 3 regulated activity;
- (d) Type 4 regulated activity, and it is not subject to the specified licensing condition;
- (e) Type 5 regulated activity, and it is not subject to the specified licensing condition;
- (f) Type 6 regulated activity, and it is not subject to the specified licensing condition;
- (g) Type 7 regulated activity;
- (h) Type 8 regulated activity;
- (i) Type 9 regulated activity, and it is not subject to the specified licensing condition,

shall, in respect of each month at the end of which it remains licensed, submit to the Commission, in the manner specified in subsections (5) and ~~(6)(d), (e) or (f) (as the case may be)~~, no later than 3 weeks after the end of the month concerned, a return, which is in the form specified by the Commission under section 402 of the Ordinance and signed in the manner specified in subsection (6), which and includes-

- (j) its liquid capital computation, as at the end of the month;
- (k) its required liquid capital computation, as at the end of the month;
- (l) a summary of bank loans, advances, credit facilities and other financial accommodation available to it, as at the end of the month;
- (m) an analysis of its margin clients, as at the end of the month;
- (n) an analysis of collateral received from its margin clients, as at the end of the month;
- (o) an analysis of its rolling balance cash clients, as at the end of the month;
- (p) an analysis of its profit and loss account;
- (q) an analysis of its client assets, as at the end of the month; and
- (r) where it is licensed for Type 3 regulated activity, an analysis of its foreign currency positions, as at the end of the month.

(2) Subject to subsection (4), a licensed corporation to which subsection (1) applies shall, in respect of each period of 3 months at the end of which it remains licensed, being such period in a year ending at the end of the month of March, June, September or December, respectively, submit to the Commission, in the manner specified in subsections (5) and ~~(6)(d), (e) or (f) (as the case may be)~~, no later than 3 weeks after the end of the period concerned, a return, which is in the form specified by the Commission under section 402 of the Ordinance and signed in the manner specified in subsection (6), which and includes-

- (a) an analysis of its clientele, as at the end of the 3 month period;
- (b) an analysis of its proprietary derivative positions, as at the end of the 3 month period;
- (c) where it is licensed for Type 3 regulated activity, an analysis of its recognized counterparties, as at the end of the 3 month period; and
- (d) where it is licensed for Type 9 regulated activity, an analysis of the assets under its management, as at the end of the 3 month period.

(3) Subject to subsection (4), a licensed corporation which is licensed solely for one or more of the following-

- (a) Type 4 regulated activity;
- (b) Type 5 regulated activity;
- (c) Type 6 regulated activity;
- (d) Type 9 regulated activity,

and subject to the specified licensing condition, shall, in respect of each period of 6 months at the end of which it remains licensed, being such period in a year ending at the end of the month of June or December, respectively, submit to the Commission, in the manner specified in subsections (5) and ~~(6)(d), (e) or (f) (as the case may be)~~, no later than 3 weeks after the end of the period concerned, a return, ~~which is~~ in the form specified by the Commission under section 402 of the Ordinance ~~and signed in the manner specified in subsection (6), which and~~ includes-

- (e) its liquid capital computation, as at the end of the 6 month period;
- (f) its required liquid capital computation, as at the end of the 6 month period;
- (g) an analysis of its profit and loss account;
- (h) an analysis of its clientele, as at the end of the 6 month period; and
- (i) where it is licensed for Type 9 regulated activity, an analysis of the assets under its management, as at the end of the 6 month period.

(4) A licensed corporation may elect to submit the return required under-

- (a) subsection (1), in respect of periods of not less than 28 days but not more than 35 days, each ending not more than 7 days before or after the end of a month;
- (b) subsection (2), in respect of periods of 3 months each ending not more than 7 days before or after the end of March, June, September or December in a year;
- (c) subsection (3), in respect of periods of 6 months each ending not more than 7 days before or after the end of June or December in a year,

determined by it on a basis according to which the ending date of each period so determined is predictable, and where it so elects and submits the return concerned, it shall be deemed to have submitted the return concerned in respect of the period required under subsection (1), (2) or (3) (as the case may be).

(5) For the purposes of this section, a licensed corporation shall submit a return referred to in this section to the Commission electronically by means of an online communication system approved by the Commission under section 58(7) for the purposes of this subsection.

~~(5) A return referred to in this section shall be signed in the manner prescribed in subsection (6) by a responsible officer or another officer of the licensed corporation approved by the Commission under section 58(5)(e) for the purposes of this section.~~

(6) For the purposes of this section -

- (a) a return referred to in this section shall be signed on behalf of the licensed corporation concerned by a responsible officer of the licensed corporation or another officer of the licensed corporation approved by the Commission under section 58(5)(e) for the purposes of this section, by way of attachment to the return of the digital signature or electronic signature of the responsible officer or other officer; and
- (b) the signature referred to in paragraph (a) shall –
 - (i) in the case of a digital signature, be supported by a recognized certificate, generated within the validity of that certificate and used in accordance with the terms of that certificate; or
 - (ii) in the case of an electronic signature, be authenticated in accordance with such directions and instructions for the use of the online communication system concerned as are published by the Commission under section 58(8).

~~(6) A licensed corporation may elect to submit a return referred to in subsection (3) to the Commission-~~

- ~~(a) electronically, by means of a secure online communication network approved by the Commission under section 58(7) for the purposes of this paragraph;~~
- ~~(b) in electronic form on a floppy disk, delivered by hand or by post to the Commission; or~~
- ~~(c) in paper form, delivered by hand or by post to the Commission;~~

and-

- ~~(d) where it submits the return in accordance with paragraph (a)-
 - ~~(i) the return shall be signed by way of attachment to the return of the digital signature of the licensed corporation, and the digital signature shall be—
 - ~~(A) supported by a recognized certificate;~~
 - ~~(B) generated within the validity of that certificate; and~~
 - ~~(C) used in accordance with the terms of that certificate~~~~
 - ~~(ii) if the return is not signed as provided for in subparagraph (i), it shall also submit a signed copy of the return in paper form, delivered by hand or by post to the Commission;~~~~
- ~~(e) where it submits the return in accordance with paragraph (b), the floppy disk shall be accompanied by a signed copy of the return in paper form; or~~
- ~~(f) where it submits the return in accordance with paragraph (c), the signed original of the return shall be submitted.~~

(6A) For the purposes of subsection ~~(6)(b)(i)(6)(d)(i)(A)~~, a digital signature is taken to be supported by a recognized certificate if it is taken to be supported by that certificate under section 2(2) of the Electronic Transactions Ordinance (Cap 553).

(7) In this section-

"digital signature" (數碼簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap 553);

"electronic signature" (電子簽署) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap 553);

"recognized certificate" (認可證書) has the meaning assigned to it by section 2(1) of the Electronic Transactions Ordinance (Cap 553);

"rolling balance cash client" (滾存結餘現金客戶) means a client of a licensed corporation in respect of whom the amounts receivable from, and amounts payable to, him by the licensed corporation arising from the purchase and sale of securities on a cash-against-delivery basis by the licensed corporation for him may be set-off by the licensed corporation under section 21(3);

"within the validity of that certificate" (在該證書的有效期內) has the meaning assigned to it by section 6(2) of the Electronic Transactions Ordinance (Cap 553).

58 Approvals

(1) to (4) and (6) No change.

(5) The Commission may, on application in writing by a licensed corporation and payment of the fee prescribed in the Securities and Futures (Fees) Rules (Cap 571 sub. leg. AF), approve-

- (a) as approved redeemable shares, any redeemable shares issued by the licensed corporation;
- (b) as an approved subordinated loan, any subordinated loan obtained by the licensed corporation;

- (c) as an approved standby subordinated loan facility, any standby subordinated loan facility obtained by the licensed corporation;
 - (d) for the purposes of section 3(3), the adoption by the licensed corporation of an accounting principle other than one of those referred to in section 3(1)(a);
 - (e) for the purposes of section ~~56(5)~~56(6), an officer of the licensed corporation to sign a return;
 - (f) for the purposes of section 41(1)(a)(v), a foreign currency; and
 - (g) the withdrawal of an election made by the licensed corporation under any provision of these Rules.
- (7) The Commission may, for the purposes of section 56(~~65~~)(a), approve ~~an secure~~ online communication ~~network~~system.
- (8) Where the Commission approves an online communication ~~network~~system under subsection (7), it shall as soon as reasonably practicable publish ~~details of the network~~directions and instructions for the use of that system in such manner as it considers appropriate.