

Our Ref: B1/15C

28 September 2006

The Chief Executive  
All Authorized Institutions

Dear Sir / Madam,

**Controls to ensure the fitness and propriety of staff of authorized institutions**

The purpose of this letter is to highlight certain internal control measures that authorized institutions (AIs) should consider adopting to ensure the fitness and propriety of their employees.

Our supervisory experience shows that registered institutions (RIs) generally have implemented controls to ensure the fitness and propriety of their relevant individuals when the Securities and Futures Ordinance regime commenced operation in April 2003. Nevertheless, as RIs increase the number of relevant individuals for existing and/or new regulated activities, we have come across cases of assessment errors and control issues relating to the registration of relevant individuals. I would therefore like to draw your attention to the circular issued on 21 February 2005 about the recommended controls for the registration of relevant individuals under section 20(1)(ea) of the Banking Ordinance as well as some good practices which we have identified through our supervisory process and now set out in [Annex 1](#).

In addition, I would like to take this opportunity to remind all AIs of the need to perform comprehensive review of potential employees regarding their history of terminated employments and convictions of offences. Please refer to [Annex 2](#) for our recommendations in this regard.

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

Yours faithfully,

Arthur Yuen  
Executive Director  
(Banking Supervision)

Encl. [Annex 1](#) (Word file, 38KB)  
[Annex 2](#) (Word file, 32KB)



**Good practices concerning controls to ensure the fitness and propriety of relevant individuals**

- (1) **Regular internal audit of the controls** – RIs should arrange for reviews, on a regular basis, by internal auditors of the controls related to the registration of relevant individuals.
- (2) **Staff performing the “fit and proper” assessment** - RIs should consider assigning a suitably qualified designated unit with an overall responsibility to ensure completion of all required checking and assessments of proposed relevant individuals before registration. If different units are involved in the checking and assessment process, there should be proper training to ensure that all responsible staff members have sufficient knowledge of the relevant regulatory requirements and internal procedures.
- (3) **“Fit and proper” assessment** - The “fit and proper” assessment should be performed preferably with the use of a standardized and comprehensive checklist. The responsible unit and staff members should maintain clear audit trails and supporting documents on the assessment of every proposed relevant individual, the results, the follow-up actions on any irregularities found, and the identity of the assessor and the approver. The assessment should be approved by an independent reviewer at a reasonable level of seniority.
- (4) **Verification of relevant industry experience** – In respect of individuals who rely on relevant industry experience gained from other institutions to exempt from licensing examination(s), RIs should establish due diligence steps to verify their relevant industry experience with previous employers to the extent practicable, instead of solely relying on the individuals’ curriculum vitae and self-declaration. For the purpose of verifying whether and in what capacity an individual was registered by his/her former employer as a relevant individual, RIs should request the former employer to provide information on the individual’s last registration status<sup>1</sup> within the former employment period. To facilitate this practice, RIs should provide this information to the new/potential employer of their former employees when they receive such a request.
- (5) **Lessons learned from assessment errors and control issues identified** –
  - (5.1) For staff who are allowed a six-month grace period to pass the local regulatory framework paper, RIs should adopt vigorous measures to ensure compliance with paragraph 4.2.10 of module SB-1 of the HKMA

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<sup>1</sup> The information should at least include the date of last registration, the types of regulated activities and the individual’s capacity.

Supervisory Policy Manual. There should be clear communications to the staff as well as their supervisors at the outset about the six-month grace period treatment and the prompt de-registration of the staff if they cannot pass the requisite examination by the end of the grace period.

- (5.2) Any staff who took up securities dealing functions of any exempt dealer AI on or after 1 April 2001 should have met the initial competence requirements of the Guidance Note on Competence (version December 2000) issued by the Securities and Futures Commission<sup>2</sup>. Those individuals who have failed to comply with these requirements (where applicable) would not be eligible for the “grandfathering” treatment set out in paragraph 4.2.6 of module SB-1 of the HKMA Supervisory Policy Manual.
- (5.3) RIs should not solely rely on the “fit and proper” assessments performed by previous employers and should clear all concerns about an individual’s initial competence requirements for the relevant regulated activities<sup>3</sup> before registering him/her as a relevant individual.
- (6) **Background checks of relevant individuals** - RIs should ensure that background checks are performed on all relevant individuals. Regarding staff transferred from overseas branches/affiliates, they should only be registered after the Hong Kong office of the RI has obtained satisfactory confirmation on the scope and results of background checks performed by the overseas branches/affiliates concerned. The background checks should at least cover those areas specified in paragraph 4.2.19 of module SB-1 of the HKMA Supervisory Policy Manual.

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<sup>2</sup> Refer to the HKMA circular "Fit and Proper Criteria for Staff of Authorized Institutions that are Exempt Dealers", which was issued on 21 March 2001 and remained effective until the commencement of the Securities and Futures Ordinance.

<sup>3</sup> An example is an individual who has not passed any licensing examination, does not possess relevant professional qualification or a degree in a designated field (or other degree with passes in at least two courses in the designated fields), and has no working experience in the securities industry.

**Other controls on potential employees**

- (1) **History of terminated employment** – Authorized institutions (AIs) should perform stringent due diligence when they recruit employees to handle client assets and/or provide financial intermediary services<sup>1</sup>. AIs should seek the potential employee's specific confirmation on whether his/her employment has ever been terminated by any previous employer, and if so, the reason for the termination. If a candidate is found to have his/her employment terminated by any previous employer, AIs should take all reasonable steps to obtain reference from the previous employer in relation to the terminated employment, and perform an assessment on the applicant's fitness and propriety for the particular capacity having regard to all relevant factors - including the reason for the termination of employment.
- (2) **Convictions of offence** – AIs should implement sufficient controls to ensure compliance with section 73(1)(b) of the Banking Ordinance (BO). This section prohibits any person who has been convicted in any place of an offence involving fraud or dishonesty, without the consent in writing of the Monetary Authority, from becoming an employee of an AI. It is important to note that this provision is applicable to convictions that have been spent by virtue of the Rehabilitation of Offenders Ordinance (Cap 297)<sup>2</sup>. In this connection, before employing any person, AIs should seek the person's specific confirmation on whether he/she has been convicted (including a conviction that has been spent under the Rehabilitation of Offenders Ordinance<sup>3</sup>) in any place of an offence involving fraud or dishonesty. If the person confirms that he/she has been so convicted, AIs should request the person to demonstrate that he/she has obtained the consent in writing of the Monetary Authority granted under section 73(1) of the BO.

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<sup>1</sup> The relevant potential employees include, but are not limited to, persons to be engaged by AIs as –

- tellers;
- relevant individuals / executive officers in the conduct of any regulated activity under the Securities and Futures Ordinance; or
- technical representatives / responsible officers in the conduct of insurance intermediary activity.

<sup>2</sup> Refer to section 4(1)(g) of the Rehabilitation of Offenders Ordinance.

<sup>3</sup> According to section 4(2)(f) of the Rehabilitation of Offenders Ordinance, the protection of rehabilitated individual shall not apply to any question asked for the assessment of the suitability to act as the employees of AIs.