

**Subcommittee on Securities and Futures Ordinance  
(Amendment of Schedule 5) Notice 2011 and  
Securities and Futures (Financial Resources) (Amendment) Rules 2011**

**The Administration's Response to Issues Raised  
at the Subcommittee Meeting Held on 17 March 2011**

This paper presents the Administration's responses to issues raised by Members of the Subcommittee at its meeting held on 17 March 2011, following the order in the letter dated 18 March 2011 from the Clerk to Subcommittee.

- I. In relation to the sanctions applicable to credit rating agencies ("CRAs") under the proposed regulatory regime, to advise the Subcommittee of –**
- (a) whether the term "misconduct" is defined in the Securities and Futures Ordinance (Cap. 571) ("SFO") or illustrated in any rule/code/guideline of the SFO regulatory regime;**
  - (b) On what ground(s) the Securities and Futures Commission ("SFC") would decide to take a disciplinary action against a regulated person for misconduct or being not fit and proper to remain a regulated person, and what rules or guidelines SFC would follow in making determinations in disciplinary proceedings;**
  - (c) whether the scope of misconduct only covers acts or omissions that are related to the regulated activity of providing credit rating services; if not, what other types of acts and omissions would also be covered and why; and**
  - (d) any precedents of disciplinary cases that can illustrate how a regulated person could be found guilty of misconduct or being not fit and proper to remain a regulated person.**

**Definition of the term "misconduct"**

2. The term "misconduct" is defined in section 193(1) of SFO, to mean -

- (a) a contravention of any of the relevant provisions as defined in Part 1 of Schedule 1 to SFO<sup>1</sup>;
- (b) a contravention of any of the terms and conditions of any licence or registration under SFO;
- (c) a contravention of any other condition imposed under or pursuant to any provision of SFO, or of any condition attached or amended under section 71C(2)(b) or (9) or 71E(3) of the Banking Ordinance (Cap. 155); or
- (d) an act or omission relating to the carrying on of any regulated activity for which a person is licensed or registered which, in the opinion of SFC, is or is likely to be prejudicial to the interest of the investing public or to the public interest.

SFC shall not form any opinion under (d) above on the nature of the act or omission in the context of interest of the investing public or the public interest unless it has had regard to such provisions in any code of conduct made or code or guideline published under SFO.

### **Definition of “fit and proper”**

3. Sections 116(3), 117(2)(e), 120(3) and 121(2)(e) of SFO compel SFC to refuse to grant a licence to carry on a regulated activity unless the applicant satisfies SFC that it/he is a “fit and proper” person to be licensed for the regulated activity. Section 129(1) of SFO provides that SFC may take into account such matter as it considers relevant in determining whether a person is fit and proper to be licensed. In addition, section 129(1) requires SFC to have regard to the following factors -

- Financial status or solvency;
- Educational or other qualifications or experience having regard to the nature of the functions which the person will perform;
- Ability to carry on the regulated activity competently, honestly and fairly; and
- Reputation, character, reliability and financial integrity.

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<sup>1</sup> Part 1 of Schedule 1 to SFO defines “relevant provisions” as the provisions of -

- (a) SFO;
- (b) Parts II and XII of the Companies Ordinance (Cap. 32), so far as those Parts relate, directly or indirectly, to the performance of functions relating to-
  - (i) prospectuses;
  - (ii) the purchase by a corporation of its own shares; and
  - (iii) a corporation giving financial assistance for the acquisition of its own shares, whether or not such functions have been made the subject of a transfer order under section 25 or 68 of SFO.

In addition, section 129(2) of SFO permits SFC to take into account any decision made by other regulatory bodies in respect of the applicant when considering its/his fitness and properness.

4. SFC published the Fit and Proper Guidelines (“F&P Guidelines”) (at **Annex A**), which, like all of SFC’s codes and guidelines, are available on its website (<http://www.sfc.hk>). The F&P Guidelines outline a number of matters that SFC will normally consider in determining whether a person is fit and proper and provide examples of when SFC is not likely to be satisfied as to a person’s fitness and properness. These include where -

- A person is an undischarged bankrupt, is subject to receivership or has failed to meet any judgment debt;
- A person has evidenced incompetence, negligence or mismanagement, which may be indicated by the person having been disciplined by a professional, trade or regulatory body;
- A person has been convicted of a criminal offence or is the subject of unresolved criminal charges which are of direct relevance to fitness and properness;
- A person has been found by a court or other competent authority for fraud, dishonesty or misfeasance.

### **Disciplinary action by SFC**

5. Pursuant to section 194(1) of SFO, SFC may (subject to certain procedural safeguards stipulated in section 198) take disciplinary action against a regulated person where he is, or was at any time, guilty of misconduct, or SFC is of the opinion that he is not a fit and proper person to be or to remain the same type of regulated person. The terms “misconduct” and “fit and proper” are stipulated in SFO as described above.

6. In making determinations in disciplinary proceedings, SFC has, separately from the safeguards for which provision is made in section 198 of SFO, developed various guidelines to enhance fairness and certainty. For example, SFC published the SFC Disciplinary Fining Guidelines in 2003 (at **Annex B**). It also issued a pamphlet, “Disciplinary Proceedings at a Glance”, in 2005 (at **Annex C**) to provide a brief overview of the disciplinary process. This pamphlet also sets out the criteria that SFC will take into account in determining whether to take disciplinary action and the level of sanctions, including:

- (a) The nature and seriousness of the conduct -
  - Impact of the conduct on market integrity
  - Costs imposed on/ losses caused to clients/ market users/ investing public
  - Nature of the conduct (e.g. whether it is intentional/ reckless/ negligent; whether prior advice was sought from advisors/ supervisors)
  - Duration and frequency of the conduct
  - Whether the conduct is widespread in the industry
  - Whether the conduct was engaged in by the firm/ individual alone or as a group and the role in that group
  - Whether there is a breach of fiduciary duty
  - (For firms) revelation of serious/ systematic management system or internal control failures
  - Whether SFC has issued any guidance concerning the conduct
- (b) The amount of profits accrued or loss avoided
- (c) Other circumstances of the firm/ individual -
  - Manner of reporting the conduct by the firm/ individual
  - Degree of co-operation with SFC and other authorities
  - Remedial steps taken since the identification of relevant conduct
  - Previous disciplinary record
  - (For individual) experience and position
- (d) Other relevant factors -
  - SFC's action in previous similar cases
  - Punishment/ regulatory action by other authorities

7. Under Part XI of SFO, a person who is aggrieved by a decision of SFC may apply to the Securities and Futures Appeal Tribunal ("SFAT") for a review of the decision. SFAT is effectively an appellate body with the ability to consider cases on their merits, which is independent of SFC and chaired by a High Court judge. If a person is dissatisfied with SFAT's decision, an appeal can be made to the Court of Appeal.

### **Scope of misconduct**

8. As mentioned above, the term "misconduct" is not confined to the actions of licensed or registered persons arising out of the conduct by them of the business for which they are licensed or registered.

Accordingly, misconduct on the part of a CRA or one of its analysts might well be unrelated its/his credit rating activities.

9. SFC considers that it is neither practical nor appropriate to stipulate each and every type of conduct which would result in SFC concluding that a person is not fit and proper to be, or to remain, licensed, or that it/he has been guilty of misconduct. SFC also considers it impracticable and inappropriate for there to be comprehensive list of the action that SFC will take in each and every situation. These determinations are made by SFC in the exercise of its discretion in all of the circumstances of each case that it is called upon to consider, but within the statutory restrictions that are imposed on it and subject to the checks and balances which are inherent in the system of review which has been created under SFAT. Conferring such discretion on a regulatory body is a universally recognised model. It enables SFC to formulate a fair and appropriate response to particular circumstances, without having its hands tied in a manner that might result in unfair consequences in some cases. Furthermore, the decisions of SFC and SFAT create a body of jurisprudence which effectively influences future decisions of SFC and leads to consistency.

### **Precedents of disciplinary cases**

10. A list of the most significant disciplinary actions, which was included in SFC's 2009/2010 Annual Report, is at **Annex D** for the purpose of illustrating the types of disciplinary actions that were taken by SFC in 2009/2010 and the circumstances in which such actions were taken.

**II. To relay to the Board of Directors of SFC and the Secretary for Financial Services and the Treasury the Subcommittee's request that the term "misconduct" should be properly defined for the purpose of the SFO regulatory regime.**

11. This request is no longer valid because, as mentioned above, SFO already defines "misconduct" in an appropriate manner and appropriately confers on SFC a discretion, which is subject to appropriate checks and balances, to reach determinations as to the existence or otherwise of misconduct in the circumstances of any particular case and the sanctions that might be imposed in appropriate cases.

**III. To research into the regulatory regimes of comparable jurisdictions to ascertain whether under any of those regimes, there are any provisions in the relevant legislation specifying criminal or civil liability on CRAs for improper conducts performed in relation to the regulated activity of providing credit rating services.**

12. Part C of Chapter 4 of the Consultation Report - Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies issued by the International Organisation of Securities Commissions (“IOSCO”) in May 2010 (“the Report”) summarises the regulatory powers to sanction CRAs for violating requirements governing their credit rating activities in various overseas jurisdictions such as the United States, the European Union, Australia and Japan. The Report does not indicate that there are any specific criminal offences arising out of the rating business carried on by CRAs in these jurisdictions. However, these overseas regulatory bodies have similar disciplinary powers to those conferred on SFC, such as -

- Revocation of licence or registration;
- Suspension of licence or registration;
- Monetary penalties; and
- Reprimand or censure.

13. In addition to the above disciplinary powers, the Report also states that many of these regulatory bodies can also refer matters for criminal prosecution for general offences. SFC believes that the regulatory regime that is proposed for CRAs in Hong Kong is similar to those existing, or being proposed, in other major jurisdictions.

**IV. In relation to “private rating”, to consider either (i) prohibiting the activity; or (ii) allowing the activity but requiring CRAs to include in the service agreement a provision to prohibit their clients from disseminating the rating result and information to the public.**

14. We do not consider it appropriate to prohibit the provision of private ratings and, similarly, do not think it appropriate to require firms conducting this type of activity to be licensed under SFO. However, we agree with the proposal to require CRAs to incorporate into their client agreements provisions prohibiting their clients from disseminating private ratings. Accordingly, SFC has revised paragraph 19 of the Code

of Conduct for Persons Providing Credit Rating Services, imposing this obligation on them (at **Annex E**).

**V. In relation to the phrase “with a reasonable expectation that they [i.e. credit ratings] will be so disseminated” in the definition of “providing credit rating services”<sup>2</sup>, to clarify whether the court is expected to apply an objective test in determining the existence of such reasonable expectation; and to consider revising the phrase to “with a reasonable *probability* (or *likelihood*) that they will be so disseminated” so as to filter out the possible dispute in relation to the term “expectation”, which would involve a subjective element.**

15. With detailed consideration of the above suggestion from the drafting and operational perspectives, we come to a view that the phrase “with a reasonable expectation that they will be so disseminated” in the definition of “providing credit rating services” could remain unchanged.

16. First, the phrase “reasonable expectation” is also used in a definition in relation to Type 7 regulated activity - “automated trading services” contained in Schedule 5 to SFO<sup>3</sup>. Adopting the same phrase in the definition of “providing credit rating services”, the new Type 10 regulated activity, will bring consistency.

17. Second, in the unlikely event of a firm/individual conducting credit rating activities without being licensed, the court will determine

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<sup>2</sup> “providing credit rating services” (提供信貸評級服務) means-

- (a) preparing credit ratings-
    - (i) for dissemination to the public, whether in Hong Kong or elsewhere; or
    - (ii) with a reasonable expectation that they will be so disseminated; or
  - (b) preparing credit ratings-
    - (i) for distribution by subscription, whether in Hong Kong or elsewhere; or
    - (ii) with a reasonable expectation that they will be so distributed; or
- but does not include-
- (c) preparing, pursuant to a request made by a person, a credit rating which is exclusively prepared for, and provided to, the person and that is neither intended for dissemination to the public or distribution by subscription, whether in Hong Kong or elsewhere, nor reasonably expected to be so disseminated or distributed; or
  - (a) gathering, collating, disseminating or distributing information concerning the indebtedness or credit history of any person;

<sup>3</sup> “automated trading services” (自動化交易服務) means services provided by means of electronic facilities... whereby...

- (b) persons are regularly introduced, or identified to other persons in order that they may negotiate or conclude, or with the *reasonable expectation* that they will negotiate or conclude sales or purchases of securities or futures contracts in a way that forms or results in a binding transaction in accordance with established methods...

whether, in the particular circumstances, a reasonable man in the same position as the firm/individual would expect that the credit ratings it/he was preparing would be disseminated to the public. Accordingly, if the client told the firm/individual that it intended to do this or had a known history of doing this, then it is likely that a court would conclude that the firm/individual must have had a “reasonable expectation”. There are objective elements in the test and would, in practice, lead to the same effect of the alternative drafting of “reasonable probability”. We consider that the current wording “reasonable expectation” has struck the right balance between preventing firms/individuals from turning a blind eye to the probability that a client might intend to publicly disseminate a “private rating” and the regulatory burden on these firms/individuals.

**VI. To rewrite paragraphs 30-32 of the paper of LC Paper No. CB(1)1613/10-11(01) in a more precise manner - To advise the Subcommittee of (a) any financial product that is regulated by credit rating requirements before such product is offered to the public; and (b) any regulatory requirement regarding the standard of credit rating applicable to regulated financial products.**

18. For funds, unlisted structured investment products or debt securities offered to the public, there is no requirement under SFO, the Companies Ordinance (Cap. 32) (“CO”) or applicable SFC product codes and guidelines, that these products be rated.

### **Debt securities**

19. Generally speaking, a document containing a public offer of shares or debentures (including plain vanilla bonds) is required to be authorised by SFC for registration as a prospectus under CO unless an exemption applies. The Seventeenth Schedule to CO sets out the exemptions.

20. The prospectus regime under CO adopts a disclosure based approach. The disclosure requirements are governed by the prospectus provisions in CO (for example, Schedule 3 to CO). There is no requirement under CO for bonds or issuer of the bonds to be rated. If credit ratings are disclosed voluntarily in a prospectus, SFC would expect the issuer to provide sufficient particulars and information on such credit ratings to enable prospective investors to make informed investment decisions.



## **Funds and unlisted structured investment products**

21. For funds and unlisted structured investment products, where an issuer voluntarily discloses any credit rating, SFC's codes including the Code on Unit Trusts and Mutual Funds ("UT Code") and the Code on Unlisted Structured Investment Products ("SIP Code") impose requirements to disclose the breakdown or meaning of the credit rating, and where appropriate, warning statements shall be inserted. In the case of unlisted structured investment products, the issuers/guarantors/other counterparties and (if applicable) the collateral are subject to eligibility requirements, and credit ratings are one of the many criteria in considering the eligibility.

22. SFC summarises the detailed requirements for credit ratings set out in the UT Code and the SIP Code in **Annex F**.

Financial Services Branch / Financial Services and the Treasury Bureau  
Securities and Futures Commission  
22 March 2011



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

## **Fit and Proper Guidelines**

適當人選的指引

**Hong Kong  
September 2006**

香港  
2006年9月

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## **1. Introduction**

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- 1.1 In most financial markets throughout the world, intermediaries providing securities, futures and foreign exchange services are required to be authorized by a regulatory authority. This requirement arises from the need for market participants generally, and investors in particular, to have confidence that the people and organizations with whom they deal are competent, honest, financially sound, and will treat them fairly.
- 1.2 Persons applying for licences and registrations under the Securities and Futures Ordinance, Cap. 571 (“SFO”) must satisfy and continue to satisfy after the grant of such licences and registrations the Securities and Futures Commission (“SFC”) that they are fit and proper persons to be so licensed or registered.
- 1.3 In simple terms, a fit and proper person means one who is financially sound, competent, honest, reputable and reliable.
- 1.4 The Fit and Proper Guidelines are made under section 399 of the SFO to replace the Fit and Proper Criteria issued in December 2000. They outline a number of matters that the SFC will normally consider in determining whether a person is fit and proper. The matters set out in these Guidelines are not exhaustive. These Guidelines do not have the force of law and should not be interpreted in a way that would override the provisions of any applicable laws, codes or other regulatory requirements.
- 1.5 These Guidelines should be read in conjunction with the Guidelines on Competence and the Guidelines on Continuous Professional Training, which set out the initial and continuous competence requirements expected of a person.

## **2. Who needs to comply with the “fit and proper” guidelines**

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2.1 The Fit and Proper Guidelines apply to a number of persons including the following:

- (a) an individual who applies for licence or is licensed under Part V of the SFO;
- (b) a licensed representative who applies for approval or is approved as a responsible officer under Part V of the SFO;
- (c) a corporation which applies for licence or is licensed under Part V of the SFO;
- (d) an authorized financial institution which applies for registration or is registered under Part V of the SFO;
- (e) an individual whose name is to be or is entered in the register maintained by the Hong Kong Monetary Authority (“HKMA”) under section 20 of the Banking Ordinance (“relevant individual”); and
- (f) an individual who applies to be or has been given consent to act as an executive officer of a registered institution under section 71C of the Banking Ordinance.

### **3. Determination of “fit and proper”**

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- 3.1 Section 129(1) of the SFO sets out a number of matters that the SFC or the HKMA (as the case may be) shall have regard to in assessing a person’s fitness and properness, which include his:
- (a) financial status or solvency;
  - (b) educational or other qualifications or experience having regard to the nature of the functions to be performed;
  - (c) ability to carry on the regulated activity competently, honestly and fairly; and
  - (d) reputation, character, reliability and financial integrity.
- 3.2 The above matters must be considered in respect of the person (if an individual), the corporation and any of its officers (if a corporation) or the institution, its directors, chief executive, managers and executive officers (if an authorized financial institution).
- 3.3 In addition, section 129(2) of the SFO empowers the SFC or the HKMA (as the case may be) to take into consideration any of the following matters in considering whether a person is fit and proper:
- (a) decisions made by such relevant authorities as stated in section 129(2)(a) or any other authority or regulatory organization, whether in Hong Kong or elsewhere, in respect of that person;
  - (b) in the case of a corporation, any information relating to:
    - (i) any other corporation within the group of companies; or
    - (ii) any substantial shareholder or officer of the corporation or of any of its group companies;
  - (c) in the case of a corporation licensed under section 116 or 117 of the SFO or registered under section 119 of the SFO or an application for such licence or registration:-
    - (i) any information relating to any other person who will be acting for or on its behalf in relation to the regulated activity; and

- (ii) whether the person has established effective internal control procedures and risk management systems to ensure its compliance with all applicable regulatory requirements under any of the relevant provisions;
  - (d) in the case of a corporation licensed under section 116 or 117 of the SFO or an application for the licence, any information relating to any person who is or to be employed by, or associated with, the person for the purposes of the regulated activity; and
  - (e) the state of affairs of any other business which the person carries on or proposes to carry on.
- 3.4 The SFC is obliged to refuse an application to be licensed if the applicant fails to satisfy the SFC that he is a fit and proper person to be licensed. The onus is on the applicant to make out a case that he is fit and proper to be licensed for the regulated activity. In relation to an application to be registered under section 119 of the SFO by an authorized financial institution, the SFC is obliged to have regard to the advice given to it by the HKMA as to whether it has been satisfied that the applicant is a fit and proper person and the SFC may rely on such advice wholly or partly.
- 3.5 Paragraphs 4 to 7 below set out matters, whether taken place in Hong Kong or elsewhere, that are likely to give rise to concerns about the fitness and properness of a person. Where “recency” of a matter of concern is mentioned in the paragraphs, it is normally taken to mean within the last 5 years for all persons.
- 3.6 Notwithstanding that a person fails to comply with all individual elements set out in these Guidelines, the SFC may nonetheless be satisfied that the person is fit and proper. The SFC will look to the substance of the requirements and the materiality of any failure to meet them. Persons who are unsure whether they meet the substance of any criteria or believe that failure to meet any requirements may not be material to their own case are encouraged to discuss their concerns with the SFC’s Licensing staff before submitting an application.
- 3.7 Persons applying for licence or approval to engage in regulated activities may be asked to attend interviews with SFC’s Licensing staff as appropriate.

#### **4. Financial status or solvency**

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4.1 The SFC is not likely to be satisfied that a person is a fit and proper person if that person:

4.1.1 *In the case of an Individual*

- (a) is an undischarged bankrupt, is currently subject to bankruptcy proceedings or is a bankrupt who has recently been discharged;

*Note: In considering whether to license a bankrupt who has been discharged, the SFC would have regard to the circumstances of the discharge and the recency of the discharge.*

- (b) is subject to receivership or other similar proceedings;
- (c) has failed to meet any judgment debt.

*Note: The SFC would have regard to the circumstances of the failure to meet a judgment debt and the recency of the failure.*

4.1.2 *In the case of a Corporation or an Authorized Financial Institution*

- (a) is subject to receivership, administration, liquidation or other similar proceedings;
- (b) has failed to meet any judgment debt;

*Note: These are requirements aimed at identifying corporations or institutions of dubious financial status or solvency. As with the same requirements in respect of individuals, the SFC would have regard to the circumstances of the failure to meet a judgment debt and the recency of the act.*

- (c) is unable to meet any financial or capital requirements applicable to it.



## 5. Educational or other qualifications or experience

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5.1 In considering the educational or other qualifications or experience, the SFC will take into account the nature of the functions which the person will perform. A person is unlikely to meet the fit and proper requirement if that person:

### 5.1.1 In the case of an Individual

- (a) applying for licence as a representative or whose name is to be entered in the register maintained by the HKMA, is under 18 years of age;
- (b) has failed to demonstrate that he is competent to perform the regulated activities efficiently and effectively.

*Note:*

(i) *The general expectations are set out in the Guidelines on Competence.*

(ii) *Competence is assessed with reference to the person's academic and industry qualifications together with relevant experience. Persons should be equipped with the skills, knowledge and professionalism necessary to perform their duties. The level of knowledge expected varies according to the level of responsibility and the type of regulated activity to be carried out. Persons are generally expected to be able to display an understanding of:*

- *the general structure of the regulatory framework that applies to their proposed activities;*
- *the particular legislative provisions, codes, guidelines and exchange rules that apply to the functions that they would perform;*
- *the fiduciary obligations owed to clients and the general obligations owed to their principals or employers; and*
- *the financial products they deal in or advise upon and the market in which the service is provided.*

## **6. Ability to carry on the regulated activity competently, honestly and fairly**

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- 6.1 A person has to demonstrate the ability to carry on the regulated activity competently, honestly and fairly; and in compliance with all relevant laws, codes and guidelines promulgated by the SFC and other regulators (where applicable). The SFC is not likely to be satisfied that a person is a fit and proper person if that person:

### **6.1.1 In the case of an Individual**

- (a) has ever been a patient as defined in section 2 of the Mental Health Ordinance to the extent that in the opinion of the SFC, after having taken into account such relevant factors including that of the person's past training, experience and qualifications, that person would be unable to carry out the inherent requirements of the regulated activity;
- (b) has evidenced incompetence, negligence or mismanagement, which may be indicated by the person having been disciplined by a professional, trade or regulatory body; or dismissed or requested to resign from any position or office for negligence, incompetence or mismanagement.

*Note: Competence and efficiency are key elements to being fit and proper. However, the weight given to events of the types listed above in considering whether a person is fit and proper will depend on a number of factors, such as the time since the event, the seriousness of the event, and the responsibility to be undertaken. As well, the source and quality of evidence will be taken into account.*

### **6.1.2 In the case of a Corporation or an Authorized Financial Institution**

- (a) has non-executive directors, key personnel (such as manager, officer, director, chief executive), substantial shareholders or other controllers who fail to meet the Fit and Proper Guidelines other than that on competence to perform regulated activities (unless such requirements are otherwise applicable);

*Note: The SFC believes that all persons involved in the management or control of licensed corporations and registered institutions must be honest and fair.*

- (b) has failed to demonstrate that it is competent to perform the regulated activities efficiently and effectively.

*Note: The general expectations are set out in the Guidelines on Competence. The competence of a person is generally assessed with reference to its organizational structure and personnel. References should be made to Appendix A of the Guidelines on Competence. The SFC is unlikely to be satisfied that the person is competent if:*

- (i) its organizational structure and personnel are unable to comply with the relevant legislative or regulatory requirements; or*
- (ii) it lacks the infrastructure and internal control systems to manage risk effectively, avoid conflict of interest and provide proper audit trail.*

## **7. Reputation, character, reliability and financial integrity**

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7.1 The SFC is not likely to be satisfied that a person is fit and proper if that person:

7.1.1 *In the case of an Individual*

- (a) was found to be of poor reputation, character or reliability, lacking in financial integrity, or dishonest. The weight given to events of the types listed below will depend on a number of factors, such as the time since the event, the seriousness of the event, and the level of responsibilities to be undertaken. Instances which, if remained unexplained, might result in the person being regarded as having failed to meet this test are where the person has been:
  - (i) found by a court or other competent authority for fraud, dishonesty or misfeasance;
  - (ii) convicted of a criminal offence or is the subject of unresolved criminal charges which are of direct relevance to fitness and properness;
  - (iii) censured, disciplined or disqualified by any professional or regulatory body in relation to any trade, business or profession;
  - (iv) refused or restricted from the right to carry on any trade, business or profession for which a specific licence, registration or other authorization is required by law;
  - (v) disqualified by a court of competent jurisdiction from being a director;
  - (vi) found culpable of market misconduct by the Market Misconduct Tribunal, or failed to abide by any codes and guidelines promulgated by the SFC, other regulators or any relevant exchanges in Hong Kong or overseas (if applicable);

(vii) a director, substantial shareholder, or involved in the management, of a corporation or business that:

- (A) was wound up (otherwise than by a solvent members' voluntary dissolution) or was otherwise insolvent or had a receiver or administrator appointed, however described;
- (B) was found guilty of fraud;
- (C) has not met all obligations to clients, compensation funds established for the protection of investors, or inter-member guarantee funds;
- (D) has been found to have committed the acts described in (i), (ii), (iii), (iv) or (vi) above.

*Note: The extent of the person's involvement in the relevant events, and the person's behaviour at that time, will have a substantial impact on the weight that the SFC attaches to the events in considering the person's fitness and properness.*

- (b) has been a party to a scheme of arrangement or entered into any form of compromise with a creditor involving a considerable amount.

*Note: Where the amount involved is in excess of HK\$100,000 or equivalent, the SFC would have regard to the recency of, and the circumstances leading to, the event.*

#### 7.1.2 In the case of a Corporation or an Authorized Financial Institution

- (a) was found to be of poor reputation or reliability, or lacking in financial integrity. Similar considerations will be given to the events described in 7.1.1(a) (i), (ii), (iii), (iv), (vi) and (vii) and 7.1.1(b) above;
- (b) has been served with a winding up petition.

## 8. Continuing requirements

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- 8.1 A person licensed or registered under the SFO, or a relevant individual or an executive officer of a registered institution must continue to be fit and proper.
- 8.2 The SFO empowers the SFC to take disciplinary actions, pursuant to section 194 or section 196 of the SFO, against a regulated person<sup>1</sup> of a licensed person or registered institution respectively if:
- (a) the person is, or was at any time, guilty of misconduct; or
  - (b) the SFC is of the opinion that the person is not a fit and proper person to be or to remain the same type of regulated person.
- 8.3 A range of sanctions is available to the SFC under the SFO. These include:
- revocation or suspension of the licence or registration of all or part of the regulated activities (only applicable to licensed persons and registered institutions);
  - revocation or suspension of approval granted as a responsible officer (only applicable to individuals);
  - public or private reprimand;
  - prohibition from applying for a licence or registration;

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<sup>1</sup> Regulated person is defined: -  
*in section 194(7) in respect of licensed persons as any one of the following:-*

- a licensed person;
- a responsible officer of a licensed corporation; or
- a person involved in the management of the business of a licensed corporation.

*in section 196(7) in respect of registered institutions as any one of the following:-*

- a registered institution;
- an executive officer of a registered institution;
- a person involved in the management of the business constituting any regulated activity for which a registered institution is or was registered; or
- an individual whose name is or was entered in the register maintained by the HKMA under section 20 of the Banking Ordinance as that of a person engaged by a registered institution in respect of a regulated activity.

- prohibition from applying for approval as a responsible officer of a licensed corporation or to be given consent to act or continue to act as an executive officer of a registered institution (only applicable to individuals);
- prohibition from having his name entered in the register maintained by the HKMA under section 20 of the Banking Ordinance (only applicable to individuals); and
- ordering the payment of a pecuniary penalty.

## **Appendix I: Additional Fit and Proper Guidelines for Corporations and Authorized Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers (“Sponsor Guidelines”)**

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### **Explanatory Notes**

The Sponsor Guidelines apply to all corporations and authorized financial institutions applying or continuing to act as sponsors<sup>1</sup> and compliance advisers<sup>2</sup>; as well as licensed individuals accredited to such corporations and relevant individuals engaged by authorized financial institutions (where applicable) for the performance of such activities.

The Sponsor Guidelines are an elaboration of the Fit and Proper Guidelines, the Guidelines on Competence, and the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (“Code of Conduct”). Where relevant, provisions within these codes and guidelines are also applicable to sponsors and compliance advisers. The Sponsor Guidelines provide additional fit and proper considerations for corporations and authorized financial institutions applying or are already licensed or registered to act sponsors and compliance advisers and do not replace the provisions set out in other sections of the Fit and Proper Guidelines.

Sponsors and compliance advisers are also reminded that in addition to the Sponsor Guidelines and the above-mentioned codes and guidelines, they must also comply with all other relevant codes, guidelines and regulations prescribed by the SFC, such as the Corporate Finance Adviser Code of Conduct. These other codes and guidelines are not diminished in any way by the more specific requirements set out in the Sponsor Guidelines.

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<sup>1</sup> “Sponsor” means a licensed corporation or registered institution licensed or registered under the SFO for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as a Sponsor appointed to act as a sponsor in respect of an application for the listing of any securities on a recognized stock market under the Listing Rules of the Stock Exchange of Hong Kong Limited (“SEHK”). A recognized stock market means a stock market operated by a company recognized as an exchange company under section 19(2) of the SFO.

<sup>2</sup> “Compliance adviser” means a licensed corporation or registered institution licensed or registered under the SFO for Type 6 regulated activity and permitted under its licence or certificate of registration to undertake work as Sponsor appointed to act as compliance adviser under the Listing Rules of the SEHK.



## **I. SPONSORS**

### **1. Competence**

The SFO requires that all licensed or registered persons must be fit and proper. In assessing whether a person is fit and proper as a licensed or registered person or to be licensed or registered with the SFC, the person's competence is one of the factors that should be taken into account. Specific competence requirements on sponsors and certain staff employed by them are set out below.

#### **1.1 Sufficient expertise and resources**

1.1.1 *General Principle 3 of the Code of Conduct provides that a licensed or registered person should have and employ effectively the resources and procedures that are needed for the proper performance of its business activities. Paragraph 4.1 of the Code of Conduct further provides that a licensed or registered person should ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).*

1.1.2 In the context of acting as a sponsor, a corporate finance firm should have sufficient expertise and resources to carry out its work. A sponsor should not undertake sponsor work and other corporate finance advisory work beyond its capacity and expertise. The Management<sup>3</sup> should ensure that the firm has the relevant expertise and adequate resources to perform its role as a sponsor properly.

1.1.3 Whenever a firm takes up an appointment as a sponsor pursuant to the requirements under the Listing Rules<sup>4</sup>, the Management should appoint a team comprising corporate finance staff ("Transaction Team"). Members of the Transaction Team should be competent in general, and in particular in the context of the work to be carried out by the team; and the team should have the manpower and resources to carry out the sponsor work to the standards expected of it under the relevant rules, regulations, codes and guidelines. A Transaction Team should have sufficient Hong Kong regulatory experience,

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<sup>3</sup> "Management" includes the firm's Board of Directors, Managing Director, Chief Executive Officer, Responsible Officers, Executive Officers or other senior management personnel.

<sup>4</sup> "Listing Rules" means the Listing Rules for the Main Board and Growth Enterprise Market ("GEM") Board of SEHK.

including knowledge of the relevant rules, regulations, codes and guidelines so that it can properly discharge its duty as a sponsor.

1.1.4 Members in one transaction team of a sponsor may work in other transaction teams of the same sponsor provided that:

- (1) the Management and the Principals<sup>5</sup> (refer to paragraphs 1.3 and 1.4 of the Sponsor Guidelines) of the respective transaction teams are satisfied on reasonable grounds that the sponsor can properly discharge its responsibilities in all the sponsor work that it undertakes;
- (2) if a Principal is assigned to supervise more than one transaction team, the Management is satisfied that each team is properly and adequately supervised by at least one Principal who has the necessary capacity, capability and competence to supervise; and
- (3) the sponsor complies with General Principle 6 and paragraph 10.1 of the Code of Conduct in respect of conflicts of interest.

1.1.5 The Management has the overall responsibility to ensure that there are sufficient staff to carry out the work throughout the period when the firm acts as a sponsor.

1.1.6 The level of human resources and expertise should be commensurate with the volume, size, complexity and nature of the sponsor work that is undertaken by a sponsor.

## **1.2 Management's responsibility**

1.2.1 *General Principle 9 of the Code of Conduct provides that 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 the firm.*

1.2.2 *Part 1 of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission ("Internal Control Guidelines") provides that the Management should ensure that there is an effective management and organisational structure which ensures that the operations of the business are conducted in a sound, efficient and effective manner. The Management should assume full*

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<sup>5</sup> "Principal" means a responsible officer or an executive officer appointed by the firm to be in charge of the supervision of the transaction team.

*responsibility for the firm's operations including the development, implementation and on-going effectiveness of the firm's internal controls and the adherence thereto by its directors and employees. Reporting lines should be clearly identified, with supervisory and reporting responsibilities assigned to the appropriate staff members.*

- 1.2.3 *Paragraph 4.2 of the Code of Conduct further provides that a licensed or registered person should ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.*
- 1.2.4 In applying the above principles to a sponsor, the Management of a sponsor is ultimately responsible for the supervision of the sponsor work undertaken by the firm, as well as compliance with all relevant rules, regulations, codes and guidelines. While the Management may delegate the operational functions to the staff of a sponsor, the Management remains responsible for the discharge of these functions and such responsibilities cannot be delegated.
- 1.2.5 The Management should appoint a Transaction Team to carry out each sponsor engagement, taking into account the considerations for the appointment and composition of the team set out in paragraphs 1.1.3 and 1.1.6. The Transaction Team should include at least one Principal who acts as the supervisor of the team.

*Note:*

*The Management should have regard to the staff's expertise, corporate finance experience, capacity and other factors that may affect the standard of sponsor work in deciding the composition of the team.*

- 1.2.6 *Part IV.6 of the Internal Control Guidelines provides that the Management should establish and maintain effective record retention policies which ensure that all relevant legal and regulatory requirements are complied with, and which enable the firm, its auditors and other interested parties, such as the SEHK and the SFC, to carry out routine and ad hoc comprehensive reviews or investigation to assess such compliance.*

### **1.3 Principals**

- 1.3.1 It is the responsibility of the Management to ensure that Principals appointed by the firm meet the criteria required in the Sponsor Guidelines. The Management should ensure that there are sufficient Principals engaged in a

full time capacity to discharge its role in supervising the Transactions Team(s), taking into account the factors set out in paragraph 1.1.6. A sponsor should have at least two Principals at all times.

- 1.3.2 In making the appointment, the Management is required to provide a written endorsement to the SFC, on behalf of the licensed corporation or registered institution, that individuals proposed to be appointed to be Principals have met the respective requirements set out in paragraphs 1.3 and 1.4.
- 1.3.3 As a general guidance, a Principal is expected to be in charge of the supervision of the Transaction Team(s). The Principal should be involved in the making of the key decisions relating to the work carried out by the Transaction Team and must be aware of the key risks in such work and responsible for the measures to address them. For example, in respect of conducting due diligence review on a listing applicant, the sponsor should ensure that the Principal is involved in determining the breadth and depth of the due diligence review, the amount of resources to be deployed for carrying out such work, making a critical assessment of the results of the due diligence and overall assessment of the adequacy of the due diligence review, and ensuring that steps have been taken to properly resolve all issues arising out of such review. The Principal is also expected to be fully conversant with the key issues in each sponsorship appointment and be able to respond and react promptly to requests of the regulators (such as the SFC and/or the SEHK) on such issues and to properly advise the applicant.

*Note:*

*The Principal should maintain an effective reporting line and communication between the Transaction Team(s) and other members in the Management regarding the sponsor work undertaken. Where circumstances require, a Transaction Team may appoint more than one Principal who, together, shall be jointly and severally responsible in discharging their roles as Principals.*

- 1.3.4 A sponsor should notify the SFC in writing of any changes in its appointment of Principals within 7 business days after making such changes; and, in the case of appointment of a Principal, file an endorsement pursuant to 1.3.2 above. The endorsement should include information, as required by the SFC that demonstrates how the Principal has met the eligibility criteria.

## 1.4 Eligibility Criteria for Principals

1.4.1 In order to qualify as a Principal, an individual should:

- (1) be a responsible officer of the licensed corporation that his licence is accredited to or an executive officer of the registered institution that has appointed him;
- (2) have acquired a minimum of 5 years of relevant corporate finance experience in respect of companies listed on the Main Board and/or GEM Board of the SEHK preceding the appointment as a Principal; and

*Note:*

*“Corporate finance experience” includes experience from providing advice on one or more of the following matters:*

- (i) initial public offerings (“IPOs”);*
- (ii) notifiable or connected transactions as defined in the SEHK Listing Rules;*
- (iii) a rights issue or open offer by a listed company in accordance with the SEHK Listing Rules;*
- (iv) takeovers and share repurchases subject to the Codes on Takeovers and Mergers and Share Repurchases; and*
- (v) any other significant transactions or equity-fund raising exercises not listed in the above.*

*And in demonstrating that a Principal has the relevant experience, the sponsor has to satisfy the SFC as to the following:*

- (a) the appointee for the role of a Principal (the “Appointee”) has acquired a majority of the relevant 5 years’ corporate finance experience from transactions that have an element of equity-fund raising by the listed issuers from the public, and the Management has to be satisfied that such experience is sufficiently recent;*

- (b) *the Appointee may acquire some (but not all) of the corporate finance experience in markets other than Hong Kong provided that these markets have comparable or higher legal and regulatory standards for listing of companies and the public offers of securities, conduct regulation on sponsors or their functional equivalents and enforcement of rules and regulations governing these respective areas. The Appointee has to demonstrate to the satisfaction of the SFC how the relevant corporate finance experience has been met if the Appointee's experience is mainly acquired overseas, and the SFC may impose such conditions on the sponsor as it considers appropriate; and*
  - (c) *the sponsor should avoid attributing the experience of all the Appointees of the firm to the same transaction in meeting this requirement.*
- (3) in the five years immediately preceding his appointment, have played a substantial role in advising a listing applicant as a sponsor in at least two completed IPOs on the Main Board and/or GEM Board of the SEHK.

*Note:*

- (1) *The SFC may exercise its discretion, on a case-by-case basis, to grant a dispensation from strict compliance with the requirements on eligibility of Principals under paragraph 1.4.1 if the firm could demonstrate that there are valid and justifiable grounds for such dispensation, which will not prejudice the overall protection of investors' interest. In considering an application for such dispensation, the SFC may take into account, without limitation, the following:*
- (a) *the nature and structure of the business of the group companies to which the sponsor belongs and internal resources and support that the group is able to provide in the carrying out of the sponsor work;*
  - (b) *the governance of the sponsor and/or its group companies by securities regulators in other leading and well-regulated markets;*

- (c) *the standards of internal controls and risk management of the firm and/or its group of companies; and*
- (d) *the compliance record of the sponsor in Hong Kong and other jurisdictions.*

*The SFC may impose any conditions or require the provision of undertakings by a sponsor and/or its group of companies as it considers appropriate in granting a dispensation abovementioned.*

- (2) *For the avoidance of doubt, the requirements set out at paragraphs 1.4.1(2) and (3) apply to Principals as initial eligibility criteria only, and are not continuing requirements. However, the Principals should at all times ensure that they remain competent in their role as Principals.*

## **1.5 Systems and Controls and Internal Assessment**

1.5.1 A sponsor should have effective systems and controls in place to ensure:

- (1) adequate supervision and management of its employees who perform the services of a sponsor;
- (2) that employees do not act beyond their proper authority; and
- (3) its compliance with all laws, regulations, codes and guidelines, including the Listing Rules, which may be applicable to the work of a sponsor.

*Note:*

*Employees carrying out any sponsor work should be adequately supervised and managed, and the Management should ensure that effective communication is maintained with staff at the operational level such that it is kept abreast of any key issues and risks areas relating to the firm's sponsor work.*

1.5.2 A sponsor should keep a complete and up-to-date list of all the sponsor work that has been and is being undertaken. The list should include the names of the companies being advised, the composition of the teams designated for the sponsor work (including any variations thereto) and the title and role of each

team member from start to finish. Such information should be made available to the SFC upon request.

- 1.5.3 A sponsor should carry out an assessment annually in order to ensure that its systems and controls remain effective. Any material non-compliance issue should be reported to the SFC promptly.

*Note:*

*The annual assessment under paragraph 1.5.3 may take the form of an internal and/or external audit. A sponsor should devise its own programme based on its assessment of risks related to its operations, the firm's business structures, its own internal systems and the track record of compliance including, but not limited to, any complaints received either from within or from third parties and any regulatory concerns raised by regulators (such as the SFC and/or the SEHK) in the period under review.*

- 1.5.4 Records of the following appointments and assessments made by the Management should be properly kept to demonstrate its compliance with the Sponsor Guidelines:

- (1) the appointment of the transaction team for each sponsor engagement under paragraphs 1.1.3 and 1.2.5;
- (2) the appointment of a responsible officer or an executive officer as a Principal under paragraph 1.3.1, the cessation of such appointment, and the decision-making process of such appointment; and
- (3) the annual assessment of the sponsor's internal systems and controls under paragraph 1.5.3.

## **2. *Minimum capital requirements***

A sponsor should have and maintain at all times sufficient resources and meet the capital requirement prescribed pursuant to the SFO and any related subsidiary legislation or codes and guidelines. Sponsors should maintain a minimum paid-up capital of HK\$10 million at all times.



### **3. Continuing professional education (“CPT”)**

- 3.1 *Part III of the Internal Control Guidelines provides, inter alia, that training policies shall be established with adequate consideration given to training needs to ensure compliance with the firm’s operational and internal control policies and procedures, and all applicable legal and regulatory requirements to which the firm and its employees are subject. Adequate training should be provided both initially and on an on-going basis.*
- 3.2 All responsible officers, executive officers, licensed representatives, and relevant individuals who engage in the sponsor work of a firm are required to attend training on topics that are relevant to their sponsor work, e.g. skills that are relevant to their role as sponsors and knowledge of the relevant regulatory rules and their changes. Training on these topics should constitute at least 50% of the 5 CPT hours (or any other amount of CPT hours as required by the SFC from time to time) that the responsible officers, executive officers, licensed representatives, and relevant individuals are required to undertake annually as holders of a corporate finance adviser licence/registration (Regulated Activity Type 6).

## **II. COMPLIANCE ADVISERS**

1. A firm must be eligible under its licence or certificate of registration to act as a sponsor (not subject to a licensing/registration condition that prohibits it from carrying out sponsor work) in order to carry out work as a compliance adviser. As corporations licensed or registered for Regulated Activity Type 6, in addition to the requirements and obligations set out in the Sponsor Guidelines, compliance advisers are required at all times to observe the relevant codes of conduct and regulations by the SFC applicable to holders of licence/registration for Type 6 Regulated Activity. These include, without limitation, the Internal Control Guidelines, the Code of Conduct, the Corporate Finance Adviser Code of Conduct, the Fit and Proper Guidelines, and the Guidelines on Continuous Professional Training.
2. In addition, all compliance advisers must be eligible to act as sponsors at all times in order to be initially eligible and continue to be eligible to act as compliance advisers. In the event that a licensed corporation or registered institution ceases to be eligible to act as a sponsor, it shall cease to be eligible to act as a compliance adviser.
3. In case of a breach by a compliance adviser of any of the relevant codes of conduct or regulations that calls to question its fitness and propriety to be a

licensed corporation or registered institution for Regulated Activity Type 6, it may cease to be eligible to be a compliance adviser, a sponsor, and/or a licensed corporation or registered institution for Regulated Activity Type 6.

G.N. 1410

## SECURITIES AND FUTURES ORDINANCE (Chapter 571)

Pursuant to section 199(1) of the Securities and Futures Ordinance, the Securities and Futures Commission published the SFC Disciplinary Fining Guidelines in the Schedule for information.

28 February 2003

Alan Linning  
Executive Director, Enforcement  
Securities and Futures Commission

### Schedule

#### **SFC Disciplinary Fining Guidelines**

##### **Securities and Futures Ordinance Considerations relevant to the level of a disciplinary fine**

These guidelines are made under section 199(1)(a) of the Securities and Futures Ordinance to indicate the manner in which the Securities and Futures Commission (SFC) will perform its function of imposing a fine on a regulated person under section 194(2) or 196(2). Section 199(1)(b) requires the SFC to have regard to these guidelines in performing its function of fining under section 194(2) or 196(2). Section 199(2) sets out some factors that the SFC should take into account in exercising its fining power among other factors that the SFC may consider. These factors are included in the considerations set out below.

Under section 194 or 196 of the Ordinance, the SFC may impose a fine either on its own or together with other disciplinary sanctions. The SFC regards a fine as a more severe sanction than a reprimand (and a public reprimand more severe than a private reprimand). The SFC will not impose a fine if the circumstances of a particular case only warrant a public reprimand. As a matter of policy, the SFC will publicise all fining decisions. This means that the SFC will never impose both a fine and a private reprimand.

When considering whether to impose a fine under section 194(2) or 196(2) and the size of any fine, the SFC will consider all the circumstances of the particular case, including the Specific Considerations described below.

A fine should deter non-compliance with regulatory requirements so as to protect the public.

Although sections 194(2)(ii) and 196(2)(ii) state that one alternative maximum level of fine that can be imposed is three times the profit made or secured, or loss avoided or reduced, the SFC will not automatically link the fine imposed in any particular case with the profit made or secured, or loss avoided or reduced.

The more serious the conduct, the greater the likelihood that the SFC will impose a fine and that the size of the fine will be larger.

In determining the seriousness of conduct, in general, the SFC views some considerations as more important than others. The General Considerations set out below describe conduct that would be generally viewed as more or less serious. In any particular case, the General Considerations should be read together with the Specific Considerations in determining whether or not the SFC will impose a fine and, if so, the amount of the fine.

### ***General considerations***

The SFC generally regards the following conduct as more serious:

- conduct that is intentional or reckless
- conduct that damages the integrity of the securities and futures market
- conduct that causes loss to, or imposes costs on, others
- conduct which provides a benefit to the firm or individual engaged in that conduct or any other person.

The SFC generally regards the following conduct as less serious and so generally deserving a lower fine:

- negligent conduct – however, the SFC will impose disciplinary sanctions including fines for negligent conduct in appropriate circumstances
- conduct which only results in a technical breach of a regulatory requirement or principle in that it:
  - + causes little or no damage to market integrity and
  - + causes little or no loss to, or imposes little or no costs on, others

- conduct which produces little or no benefit to the firm or individual engaged in that conduct and their related parties.

These are only general considerations. These considerations together with the other circumstances of each individual case including the Specific Considerations described below will be determinative.

### *Specific considerations*

The SFC will consider all the circumstances of a case, including:

#### *The nature and seriousness of the conduct*

- the impact of the conduct on the integrity of the securities and futures market
- whether significant costs have been imposed on, or losses caused to others, especially clients, market users or the investing public generally
- whether the conduct was intentional, reckless or negligent, including whether prior advice was sought on the lawfulness or acceptability of the conduct either by a firm from its advisors or by an individual from his or her supervisors or relevant compliance staff of the firm or group that employs him or her
- the duration and frequency of the conduct
- whether the conduct is widespread in the relevant industry (and if so, for how long) or there are reasonable grounds for believing it to be so widespread
- whether the conduct was engaged in by the firm or individual alone or whether as part of a group and the role the firm or individual played in that group
- whether a breach of fiduciary duty was involved
- in the case of a firm, whether the conduct reveals serious or systematic weaknesses, or both, in respect of the management systems or internal controls in relation to all or part of that firm's business
- whether the SFC has issued any guidance in relation to the conduct in question

*The amount of profits accrued or loss avoided*

- a firm or individual and related parties should not benefit from the conduct

*Other circumstances of the firm or individual*

- a fine should not have the likely effect of putting a firm or individual in financial jeopardy. In considering this factor, the SFC will take into account the size and financial resources of the firm or individual. However, if a firm or individual takes deliberate steps to create the false appearance that a fine will place it, him or her in financial jeopardy, eg by transferring assets to third parties, this will be taken into account
- whether a firm or individual brings its, his or her conduct to the SFC's attention in a timely manner. In reviewing this, the SFC will consider whether the firm or individual informs the SFC of all the conduct of which it, he or she is aware or only part, and the manner in which the disclosure is made and the reasons for the disclosure
- the degree of cooperation with the SFC and other competent authorities
- any remedial steps taken since the conduct was identified, including any steps taken to identify whether clients or others have suffered loss and any steps taken to sufficiently compensate those clients or others, any disciplinary action taken by a firm against those involved and any steps taken to ensure that similar conduct does not occur in future
- the previous disciplinary record of the firm or individual, including an individual or firm's previous similar conduct particularly that for which it, he or she has been disciplined before or previous good conduct
- in relation to an individual, his or her experience in the industry and position within the firm that employed him or her

*Other relevant factors, including*

- what action the SFC has taken in previous similar cases – in general similar cases should be treated consistently
- any punishment imposed or regulatory action taken or likely to be taken by other competent authorities
- result or likely result of any civil action taken or likely to be taken by third parties – successful or likely successful civil claims may reduce the part of a fine, if any, that is intended to stop a person benefiting from their conduct.



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

Annex C

## **Disciplinary Proceedings at a Glance**

**紀律處分程序概覽**

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## **SFC Disciplinary Proceedings at a Glance**

This pamphlet is intended to provide a brief overview of our disciplinary process. Under Part IX of the Securities and Futures Ordinance (“SFO”) the SFC is given power to discipline those that it licenses or registers, comprising firms and those who perform functions for them which require a licence or registration including those involved in their management<sup>1</sup> (together referred to as “regulated persons”). If the SFC finds that a regulated person’s conduct suggests it is guilty of misconduct or not fit and proper, the SFC may impose sanctions selected from a range set out in the SFO. This pamphlet explains how we go about this process.

This pamphlet is not about other actions that the SFC may take such as civil proceedings before the High Court, criminal proceedings before the Magistrates’ Court (eg for breach of the disclosure of interests provisions in Part XV of the SFO) or proceedings before the Market Misconduct Tribunal. The SFC will describe these in the future on its website in our Regulatory Handbook.

### **Why does the SFC discipline?**

Under the SFO, one of the SFC’s functions is to protect the interests of investors and to maintain market integrity. One of the ways we do this is by enforcing the law through imposing disciplinary sanctions on regulated persons. Through discipline, the SFC ensures firm and appropriate action is taken against those who harm investors or damage market integrity, regardless of their position and status. The threat of sanctions being imposed by the SFC serves to deter non-compliance with regulatory requirements.

It is of paramount importance to us that all regulated persons are treated fairly in the disciplinary process. When making disciplinary decisions, the SFC will have regard to its previous decisions while taking into account the specific circumstances of each case. However, the Securities and Futures Appeals Tribunal<sup>2</sup> has ruled that the SFC may disregard previous decisions where changed circumstances warrant it. The SFC will adjust its penalties from time to time in light of various considerations it deems relevant to the discharge of its statutory duties and to changing market circumstances, particularly market participants’ behaviour. The SFC aims at all times to impose sanctions which are proportionate to the gravity of the improper conduct.

### **Who is subject to SFC disciplinary action?**

As noted above the SFC has power to take disciplinary action against regulated persons only. This means: licensed or registered corporations; representatives and responsible officers of licensed corporations; executive officers and relevant individuals of registered corporations; and those who are not licensed or otherwise given a regulatory approval but are involved in the management of a licensed or registered corporation.

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<sup>1</sup> The SFC also disciplines under the old law in relation to conduct which occurred before the commencement of the SFO on 1 April 2003 by virtue of certain transitional provisions in Schedule 10 of the SFO. This is likely to continue for some years to come.

<sup>2</sup> See page 7 for a discussion of the role of the Tribunal.



## Criteria for determining whether to take disciplinary action and the level of sanctions

The SFC will consider all the circumstances of a case, including:

- The nature and seriousness of the conduct
  - impact of the conduct on market integrity
  - costs imposed on/losses caused to clients/market users/investing public
  - nature of the conduct (eg whether it is intentional/reckless/negligent; whether prior advice was sought from advisors/supervisors)
  - duration and frequency of the conduct
  - whether the conduct is widespread in the industry
  - whether the conduct was engaged in by the firm/individual alone or as a group and the role in that group
  - whether there is a breach of fiduciary duty
  - (for firms) revelation of serious/systematic management system or internal control failures
  - whether the SFC has issued any guidance concerning the conduct
- The amount of profits accrued or loss avoided
- Other circumstances of the firm/individual
  - manner of reporting the conduct by the firm/individual
  - degree of co-operation with the SFC and other authorities
  - remedial steps taken since the identification of relevant conduct
  - previous disciplinary record
  - (for individuals) experience and position
- Other relevant factors
  - SFC's action in previous similar cases (note: usually similar cases would be treated consistently. However, if the misconduct has become prevalent or widespread in the market, the SFC may impose a heavier sanction than in the past)
  - punishment/regulatory action by other authorities

The criteria listed above are **not exhaustive**.

## Disciplinary measures available to the SFC

The SFC is empowered to impose one or more of the following sanctions:

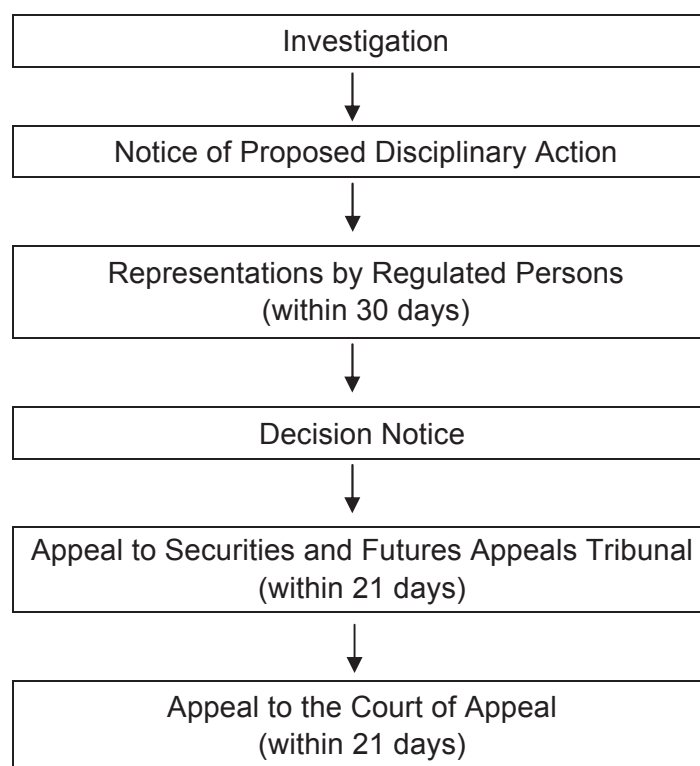
- **revocation** or **partial revocation** of licence or registration
- **suspension** or **partial suspension** of licence or registration
- **revocation** of approval to be a responsible officer
- **suspension** of approval to be a responsible officer
- **prohibition** of application for licence or registration
- **prohibition** of application to become a responsible officer, executive officer or relevant individual
- **fines** (up to the maximum of \$10 million or 3 times of the profit gained/loss avoided, whichever is the higher)
- **reprimands** (private or public)

All the SFC's sanctions, other than a private reprimand, will be published by means of a press release. All press releases on SFC enforcement actions, including disciplinary actions, are available on the SFC website ([www.hksfc.org.hk](http://www.hksfc.org.hk)) under "Enforcement News".

To better understand the considerations of the SFC when imposing a fine, please refer to the SFC Disciplinary Fining Guidelines published in March 2003, which can be found on the SFC website under "Regulatory Handbook"- "Codes, Guidelines and Circulars".



## Disciplinary process



### Investigation

The SFC investigates acts that suggest misconduct or that call into question the fitness and properness of a regulated person. The SFC may initiate an investigation on the basis of information from any source, including the public, other regulators or law enforcement agencies in Hong Kong, such as the Hong Kong Monetary Authority and the Police, foreign regulators, Hong Kong Exchanges and Clearing Limited, and internal referrals. Internal referrals may arise from the SFC's monitoring of day-to-day trading in the stock and derivatives markets, from the SFC's inspections of intermediaries or from investigations into other matters, such as civil market misconduct or criminal offences. Following the investigation, the SFC will consider whether or not there is sufficient evidence to commence disciplinary proceedings.

The SFC's disciplinary investigations should not be confused with those of other bodies, such as the Hong Kong Police or the ICAC, who investigate suspected criminal behaviour, or other bodies with the power to discipline, such as Hong Kong Exchanges and Clearing Limited.

### Notice of proposed disciplinary action (NPDA)

An NPDA is sent to the regulated person if the SFC decides to start disciplinary proceedings. The NPDA sets out the findings of the SFC investigation into apparent misconduct and/or acts that call into question the fitness and properness of the regulated person. It also states the sanctions the SFC considers appropriate to impose on the basis of the facts as it understands them at the time.

## **Representations by regulated persons**

In the NPDA, the SFC invites the regulated person to explain the matter and why the proposed sanctions are not appropriate. Representations should be made in writing to the person who signed the NPDA. Representations should not be made to other SFC directors or officers, as they will not be involved in making the decision.

The SFC expects representations on the facts and proposed sanctions to be made at the same time.

## **An opportunity to be heard**

Before exercising any power to discipline, the SFC must first give the regulated person a reasonable opportunity to be heard by allowing the regulated person to make representations explaining the matter and commenting on the appropriateness of the proposed sanctions. Under normal circumstances, the regulated person is given 30 days to make representations. However, the SFC will consider reasonable requests for further extensions (eg to consider complex evidence).

If a response is not provided before the deadline stated in the NPDA, the SFC will make a final decision on the sanctions based on the evidence before it and it is likely that the SFC will impose the sanctions proposed in the NPDA. The SFC will then send another letter informing the regulated person of the decision and the reason for imposing the sanctions.

## **Legal representation**

A regulated person may wish to get legal advice, which may include instructing their lawyer to make representations to the SFC on their behalf.

## **Request for evidence when making representations to the SFC**

When the SFC issues an NPDA to the regulated person setting out the proposed sanctions, the SFC will also provide the regulated person with a list of documents on which the SFC has relied in reaching its preliminary finding of improper conduct. The regulated person may ask for a copy of documents on the list from the SFC.

## **Meeting the SFC**

Disciplinary proceedings are normally determined on the basis of written submissions. However, a regulated person may ask for a meeting with the SFC to make oral submissions. If a regulated person wants to have a meeting with the SFC, he must apply to the SFC in writing explaining why he thinks it is necessary. The SFC will hold a meeting with the regulated person if it considers fairness in the circumstances requires a meeting.

In the course of disciplinary proceedings, if fairness in the circumstances demands, the SFC may invite the regulated person to attend a meeting to clarify certain issues even without an application from that person. The SFC may notify a regulated person of its decision to hold a meeting in these circumstances in the NPDA or after receiving written submissions.



## **Decision notice**

The SFC will review all information submitted by the regulated person in their representations together with all the evidence it already possesses. The SFC will then send a decision notice in writing to the regulated person detailing the SFC's decision. The decision notice will set out:

- the reasons for the decision;
- the time at which the decision is to take effect;
- the duration and terms of any revocation, suspension or prohibition to be imposed;
- the terms of any reprimand under the decision; and
- the amount of any fine that may be imposed as well as the date by which it must be paid.

The decision notice will also include information on the regulated person's right to appeal to the Securities and Futures Appeals Tribunal against the decision.

## **Settlement of disciplinary proceedings**

A regulated person may make a settlement proposal to the SFC. The SFC has power to settle disciplinary proceedings by agreement when the SFC considers it appropriate to do so in the interest of the investing public or in the public interest. Whether the SFC will settle a case depends on the facts and circumstances of individual cases. Normally, the SFC will consider settlement proposals after it has received representations from the regulated person. The SFC will consider every settlement proposal very carefully, and will agree to enter into settlement negotiations if the SFC considers it appropriate and in the interest of the investing public or in the public interest to do so. All discussions about settlement will be treated as "without prejudice", unless the regulated person and the SFC agree otherwise. "Without prejudice" means that neither the SFC nor the regulated person may refer to those discussions in the disciplinary proceedings or subsequent legal proceedings unless there is a subsequent dispute as to whether or not a settlement was concluded.

## **Co-operation with the SFC**

In deciding on the final sanctions, the SFC will consider whether the regulated person co-operates with the SFC. In appropriate circumstances, the sanctions may be reduced depending on the degree of co-operation.

## **Appeal to the Securities and Futures Appeals Tribunal**

The decision of the SFC is subject to appeal to the Securities and Futures Appeals Tribunal which is an appellate body independent of the SFC and chaired by a High Court judge. A regulated person, if aggrieved by the decision of the SFC, may appeal the decision by submitting a notice in writing to the Securities and Futures Appeals Tribunal within 21 days after a decision notice is served or given. The time for appealing may be extended by applying to the Securities and Futures Appeals Tribunal and demonstrating good cause.

The notice to the Securities and Futures Appeals Tribunal must set out clearly the grounds for the appeal.

The notice to the Securities and Futures Appeals Tribunal should be delivered to the Secretary to the Securities and Futures Appeals Tribunal at:

The Securities and Futures Appeals Tribunal  
38th Floor, Immigration Tower  
7 Gloucester Road, Wan Chai  
Hong Kong  
(Tel: 2827 1470)

### **Effective date of a decision**

If the regulated person does not appeal the SFC's decision within 21 days, the decision will take effect at the time when the period expires.

If, within the 21 days appeal period, the regulated person informs the SFC, whether in writing or orally, that they will not appeal the decision, the decision will take effect at the time the SFC receives the notification.

If, within the 21 days appeal period, the regulated person appeals, the decision will not take effect until the Securities and Futures Appeals Tribunal makes a final decision. However, if the regulated person withdraws his appeal, the SFC's decision will take immediate effect.

### **Appeal to the Court of Appeal**

If the regulated person is dissatisfied with the Securities and Futures Appeals Tribunal's decision, an appeal can be made to the Court of Appeal. The regulated person must appeal within 21 days from the date on which the Securities and Futures Appeals Tribunal makes a final decision. The regulated person may appeal only on a point of law and not on whether the Securities and Futures Appeals Tribunal's decision was the right one to make or if the Securities and Futures Appeals Tribunal misinterpreted the facts.

### **Paying a fine**

If the regulated person is ordered to pay a fine, the fine must be paid to the SFC by the deadline specified in the decision notice, by cheque made payable to the "Securities and Futures Commission" and sent to:

The Securities and Futures Commission  
(Attn: Director of Finance and Administration)  
8th Floor, Chater House  
8 Connaught Road Central  
Hong Kong

Please quote the SFC's case reference which is quoted on the SFC correspondence relating to matter (eg 508/EN/123).

### **Summary only, not legal advice**

This is a summary for reference only. It is not legal advice. A regulated person should seek their own legal advice.

8th Floor, Chater House, 8 Connaught Road Central, Hong Kong 香港中環干諾道中八號遮打大廈八樓



Table 15 Most significant disciplinary actions

Item	Company/Name	Date of action	Conduct	Action / SFAT decision
1	Tsun Chi Yuen Securities Company Ltd Tsun Chi Shing, Alfred	31.3.2010	Failure to prevent and stop one of its representatives from trading certain warrants in an abusive manner which falsely inflated their turnover	Reprimanded and fined \$2 million Licence suspended for 12 months
2	Fong Yen-hwung, Ryan	24.3.2010	Engaging in insider dealing activities	Banned for life
3	Li Kwok Keung, Asser	23.3.2010	Providing misleading information to the SFC	SFAT decided to suspend Li for 18 months
4	Hui Chui Yiu, Emily	16.3.2010	Conducting transactions in clients' accounts without consent from clients	Banned for two years
5	Hung Chi Wah	9.3.2010	Defrauding clients	SFAT affirmed the SFC's decision to ban Hung for life
6	Fukoku Investment (Asia) Ltd Wong Kin Man Anthony	25.2.2010	Failure to detect and stop an unlicensed firm from carrying out activities that appeared to be a boiler room scam	Reprimanded and fined \$2 million Licence suspended for two years and RO approval revoked
7	Chau Chin Hung, Edmond	28.1.2010	Engaging in market misconduct activities including false trading and price rigging	Reprimanded, fined \$2 million and banned for life
8	Chau Sik Ki	14.1.2010	Misappropriation for clients' assets	Revocation and banned for life
9	Karl Thomson Investment Consultants Ltd	12.1.2010	Sale of Minibonds	Karl Thomson repurchased Minibonds from 11 customers involving a return of around \$1.4 million to customers
10	Dah Sing Bank Ltd Mevas Bank Ltd	23.12.2009	Distribution of Principal Protected Notes (PPNs) issued by a Lehman Brothers group entity	Dah Sing and Mevas repurchased PPNs from about 529 customers involving a return of about \$72 million to customers
11	Grand Cathay Securities (Hong Kong) Ltd	17.12.2009	Distribution of Minibonds	Grand Cathay repurchased Minibonds from 37 customers involving a return of over \$30 million to customers
12	Cheung Sau Lin, Connie	17.12.2009	Failure to deter false trading and price rigging orders made by staff	Licence suspended for three years
13	Lam Kar Fai, Allen	23.11.2009	Insider dealing	Banned for life
14	Grand Investment (Securities) Ltd	2.11.2009	Failure to prevent clients from trading in an abusive manner	Reprimanded and fined \$3 million
	Lee Tak Lun		Failure to monitor clients' trading activities	Licence suspended for 12 months
	Chung Wing Han, Wendy		Failure to monitor clients' trading activities	Licence suspended for 18 months

**Table 15 Most significant disciplinary actions (cont'd)**

Item	Company/Name	Date of action	Conduct	Action / SFAT decision
15	Asia Pacific Securities Ltd Chan Yau Fung, Canice	22.10.2009	Breach of FRR requirements	Reprimanded and fined \$1.4 million Revocation
16	Sun Hung Kai Investment Services Ltd	12.10.2009	Insufficient internal controls to prevent staff misconduct	Reprimanded and fined \$4 million
17	Lin Ko Ming	5.10.2009	Failure to conduct properly as a responsible officer and breaching the GEM Listing Rules	Banned for seven years
18	Ko Wai Lun, Aaron	24.9.2009	Unauthorised trades; forgery of client signature; providing misleading information and lying to the employer	Banned for 10 years
19	Kwan Chi Shing, Stephen	8.9.2009	Misrepresentation in licence application	Banned for life as responsible officer and three years as licensed representative
20	Yenn Man Han, Stephen	26.8.2009	Placing manipulative orders and conducting wash sales in pre-opening and closing auction sessions for a number of stocks	Licence suspended for 12 months
21	Shun Loong Securities Co Ltd Wilhelm Soeharsono Budihardjo	19.8.2009	Failure to monitor clients' abusive trading activities	Reprimanded and fined \$2 million Licence suspended for 12 months
22	Yuen Shing Kuen	30.7.2009	Failure to take appropriate action on suspicious instructions received from a client	Licence suspended for two years
23	VC Capital Ltd	27.7.2009	Failure to conduct adequate due diligence as sponsor	Reprimanded and fined \$1.5 million
24	ABN AMRO Bank N.V. Bank of China (Hong Kong) Ltd Bank of Communications Co Ltd The Bank of East Asia, Ltd Chiyu Banking Corporation Ltd Chong Hing Bank Ltd CITIC Ka Wah Bank Ltd Dah Sing Bank Ltd Fubon Bank (Hong Kong) Ltd Industrial and Commercial Bank of China (Asia) Ltd Mevas Bank Ltd Nanyang Commercial Bank Ltd Public Bank (Hong Kong) Ltd Shanghai Commercial Bank Ltd Wing Hang Bank Ltd Wing Lung Bank Ltd	22.7.2009	Distribution of Minibonds	16 banks agreed to repurchase Minibonds from their customers. This involved an immediate return of about \$5.5 billion to more than 29,000 customers plus potential further return from collateral recovery. The banks also agreed to investigate and review complaints made by customers of other unlisted structured products and remediate them where appropriate. In addition, the 16 banks have engaged independent reviewers to comprehensively review their internal controls and complaint handling procedures.

**Table 15 Most significant disciplinary actions (cont'd)**

Item	Company/Name	Date of action	Conduct	Action / SFAT decision
25	Wong Wang, Ronnie	9.7.2009	Unauthorised trades	Banned for two years
26	Chan Sheung Ling	6.7.2009	Facilitating secret accounts and use incorrect report to compile financial return which was in breach of the Client Money Rules	Banned for life
	Li Agnes		Operating secret accounts and abusing employer's settlement process	Banned for life
27	Leung Yu Fung	25.6.2009	Misappropriation of clients' assets	Banned for life
28	Ng Shui King	23.6.2009	Failure to comply with account-opening procedures and received instructions from the unlicensed person without proper authorisation	Licence suspended for two years and six months
29	Chan Wang Fai	8.6.2009	Front running	Revocation and fined for \$930,000
30	Law Kai Yee	2.6.2009	Unlicensed leveraged forex trading	SFAT upholds SFC's disciplinary decisions to suspend Law's licence for two years and three months
	Ng Chiu Mui		Unlicensed leveraged forex trading	Revoked licence and banned for 10 years
	Tang Yuen Ting		Unlicensed leveraged forex trading	Banned Tang for nine months and fined \$1,455,496
31	Tanrich Futures Ltd	2.6.2009	Cold calling breaches	Reprimanded and fined \$4 million
	Yip Man Fan		Neglected management responsibility	Banned for nine months
32	Yip Kim Wah	19.5.2009	Conducted unauthorised and negligent trading resulting in client's losses	Banned for life
33	Pang Keng Chan	14.4.2009	Failure to take appropriate actions against suspicious instructions from a client	Licence suspended for two years
34	KGI Asia Ltd	5.4.2009	Distribution of Minibonds	KGI repurchased Minibonds from five customers involving \$1.6 million

## Code of Conduct for Persons Providing Credit Rating Services

19. A CRA should ensure that any “private rating” (prepared by the CRA pursuant to a request made by a person which is exclusively prepared for, and provided to, the person and that is neither intended for dissemination to the public or distribution by subscription, whether in Hong Kong or elsewhere, nor reasonably expected to be so disseminated or distributed), is only subsequently disseminated to the public or distributed by subscription, whether in Hong Kong or elsewhere, if such rating has been prepared in compliance with the provisions of this Code. In the case of a CRA providing a private rating, the CRA should by prior written agreement entered into between it and the rated entity, prohibit the rated entity from disseminating such rating, or permitting its dissemination, to the public.

## Summary of Regulatory Requirements for Credit Ratings in the UT Code and the SIP Code

Product	Code provision	Type of requirement	Particulars of requirement
Unit trusts and mutual funds	8.5(c), UT Code	Disclosure in offering document (for guaranteed funds)	Information on the guarantor's credit rating (where applicable).
Unit trusts and mutual funds	Appendix C2A(g), UT Code	Disclosure in offering document	Breakdown of the credit ratings of collateral (where applicable) –  E.g. where the fund manager chooses to adopt some minimum credit ratings for any part of the collateral of the fund.
Unit trusts and mutual funds	"Holdings of collateral" section in Appendix E, UT Code	Disclosure in annual report (for schemes holding collateral of more than 30% of the NAV)	Credit rating of the collateral (if applicable) and a breakdown –  See above example.
Unlisted structured investment products	Appendix A1(b), SIP Code	Issuer (or guarantor, if applicable) eligibility	Appendix A1(a) requires that the entity shall have a net asset value of not less than HK\$2 billion.  Appendix A1(b) requires that the entity shall either:- <ul style="list-style-type: none"> <li>(i) be a Regulated Entity or</li> <li>(ii) have a credit rating which is one of the top three investment grades awarded by at least one rating agency of international standing and reputation which is acceptable to the SFC.</li> </ul>

Product	Code provision	Type of requirement	Particulars of requirement
			<p><i>Note 1: A credit rating which is presently of such grade but which is under review for possible downgrading to less than such grade will not be regarded as fulfilling this requirement.</i></p> <p><i>Note 2: The above eligibility requirements are similar to those required of issuers/guarantors of listed derivative warrants and callable bull/bear contracts under Chapter 15A of the Main Board Listing Rules.</i></p> <p>And, in either case, the entity shall not be the subject of any proceeding for winding up, or be deemed to be insolvent, or have entered into any restructuring of debts (see Appendix A1(c)).</p>
Unlisted structured investment products	5.13(c), SIP Code	Criteria for collateral	<p>5.13 of the SIP Code sets out the eligibility criteria for collateral. Sub-paragraph (c) provides that:-</p> <p>the collateral shall have a credit rating which is one of the top three investment grades awarded by at least one rating agency of international standing and reputation which is acceptable to the SFC.</p> <p>Other criteria include, e.g. that the collateral shall not include (i) structured products or (ii) securities issued by special purpose vehicles (see 5.13(d) of the SIP Code)</p>

Product	Code provision	Type of requirement	Particulars of requirement
Unlisted structured investment products	Appendix C25, SIP Code	Disclosure in offering documents	<p>Where a credit rating of a structured investment product, the Issuer of such structured investment product, any reference asset or any collateral is given in an offering document, it shall be accompanied by:</p> <p>(a) the source of the credit rating, which must be a rating agency of international standing and reputation acceptable to the SFC;</p> <p>(b) an explanation of what the credit rating means, including the class and/or type of rating and the specific entity or obligation rated; and</p> <p>(c) an appropriate warning to the effect that the credit rating (i) is not a recommendation, (ii) is not necessarily an indication of liquidity or volatility, and</p> <p>(iii) may be downgraded if the credit quality of the relevant entity or asset or obligation declines.</p> <p><i>Note: (1) Where a negative outlook has been assigned, such fact shall be disclosed.</i></p> <p><i>(2) Where the structured investment product is not rated, such fact shall be disclosed.</i></p>
Unlisted structured investment products	Appendix D23, SIP Code	Presentation in advertisements	Where a credit rating of a structured investment product, the Issuer of such structured investment product, any reference asset or any collateral is given in an advertisement, it shall be

Product	Code provision	Type of requirement	Particulars of requirement
			<p>accompanied by:</p> <p>(a) the source of the credit rating, which must be a rating agency of international standing and reputation acceptable to the SFC;</p> <p>(b) either an explanation of what the credit rating means, including the class and/or type of rating and the specific entity or obligation rated, or a cross-reference to an explanation of what it means located in the offering document; and</p> <p>(c) an appropriate warning to the effect that the credit rating (i) is not a recommendation, (ii) is not necessarily an indication of liquidity or volatility, and</p> <p>(iii) may be downgraded if the credit quality of the relevant entity or asset or obligation declines.</p> <p><i>Note: Where a negative outlook has been assigned, such fact shall be disclosed.</i></p>