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B1/15C

24 March 2003

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Executive officers of registered institutions

You will be aware from my letters of 5 July and 12 September 2002 that the Banking (Amendment) Ordinance 2002 (BAO 2002) requires every authorized institution (AI) registered with the Securities and Futures Commission (i.e. registered institution, or RI) to appoint executive officers (EOs) and such appointment must have the prior consent of the Monetary Authority. This letter sets out the relevant requirements and procedures that should be observed by a RI in the appointment of any EO. In addition, it serves to highlight various significant issues relating to EOs.

You should pay attention to this letter if it is the intention of your institution to become a RI.

Introduction

As mentioned in my letter of 5 July 2002, sections 71C to 71E of the revised Banking Ordinance (BO) introduce new requirements in respect of EOs. Every RI shall appoint not less than **two** EOs to be responsible for directly supervising the conduct of each regulated activity under the Securities and Futures Ordinance (SFO). As stipulated in section 119 of the SFO, it shall be a condition of registration that for each regulated activity, there is at least one EO available at all times to supervise the business. The same individual may be appointed to be an EO for one or more regulated activities.

Transitional arrangements

There will be a transitional period of two years from the commencement of the SFO (i.e. from 1 April 2003) for deemed RIs¹ to apply to become RIs. It is stated in the new section 71F of the BO that the requirements in relation to EOs shall not apply to deemed RIs during the transitional period. In other words, deemed RIs need not appoint EOs immediately upon commencement of the BAO 2002.

Notwithstanding the transitional arrangements, deemed RIs should identify well in advance the individuals that will fulfil the role of EOs in each of the regulated activities they will undertake.

It should be noted that individuals who are engaged by deemed RIs to perform functions similar to that of an EO but who are not formally appointed as EOs during the transitional period are nevertheless relevant individuals, and as such their specified particulars should be included in the HKMA Register².

Application for the consent of the Monetary Authority to become an EO***Application procedures and forms***

Under the new section 71C of the BO, no person may become an EO of a RI without the consent in writing of the Monetary Authority. It is therefore necessary for an AI to ensure that —

- application to the HKMA for consent to the proposed appointment of EOs, using the standard Form C attached in **Annex 1** and providing the required supporting documents as set out in the form, will be made not later than its application to the Securities and Futures Commission (SFC) to become a RI³; and
- the individual concerned must not become or act as an EO prior to obtaining the Monetary Authority's consent.

The standard application form is also available on the HKMA's private website for AIs (www.hkfin.net).

Upon receiving an application, the HKMA will (normally within 3 business days) issue a letter of acknowledgement to the AI concerned, accompanied by a copy of a letter specifying the purposes for which an EO applicant's personal data collected by the HKMA are to be used and the classes of persons to whom the data may be transferred.

Assessment of an application to become an EO

In considering whether to grant consent to an individual applying to become an EO of a RI, the HKMA will evaluate -

- a. whether the applicant is a fit and proper person to be an EO of the institution concerned, and
- b. whether the applicant has sufficient authority within the institution concerned to be such EO.

It is the responsibility of an applicant to satisfy the HKMA that he is fit and proper and has sufficient authority within the institution concerned to be such EO. The HKMA may request the applicant to provide additional information and documents.

Assessment of an applicant's fitness and propriety

The HKMA will take into account the factors set out in section 129 of the SFO as well as those requirements stipulated in the Fit and Proper Guidelines and the Guidelines on Competence to be issued by the SFC that are applicable to responsible officers of licensed corporations.

For smooth transition to the new securities supervisory regime and consistency with the SFC's treatment of potential responsible officers of deemed licensed corporations, there will be a "grandfather" arrangement for EOs of deemed RIs. Individuals who have been directly supervising the conduct of any regulated activity(ies) immediately before the commencement of the SFO will be exempt from the relevant initial competence requirements if the individual concerned becomes an EO in respect of the same regulated activity(ies) within 3 years after the commencement of the SFO (with consent granted by the Monetary Authority).

Where an individual applies to become an EO for more than one regulated activity, the HKMA is unlikely to give consent in respect of all such regulated

activities if there is potential conflict of interest. This may arise if, say, Type 6 (advising on corporate finance) and Type 9 (asset management) regulated activities are supervised by the same individual at the same time. A possible exception is where the proposed EO comes from the very top level of management overseeing a substantial part of the institution's operations, e.g. the Chief Executive, an Alternate Chief Executive, or a Director.

If an individual applies to be an EO for Type 6 regulated activity and intends to give advice on matters falling within the ambit of the Codes on Takeovers and Mergers and Share Repurchases ("codes-related matters"), he must satisfy the HKMA that he has sufficient experience in this area. For this purpose, the HKMA will take into account the views of the SFC. If the applicant cannot satisfy the HKMA in this regard, the consent, if granted in due course, will be subject to the condition that the applicant cannot act as a sole EO of the RI in relation to codes-related matters. In such case, the RI must appoint at least one other EO (who is not subject to this condition) to directly supervise the conduct of advising on any codes-related matters.

Assessment of an applicant's sufficiency of authority

As a general guideline, if any of the individuals responsible for directly supervising the conduct of a regulated activity is the Chief Executive, an Alternate Chief Executive, or a Director of a RI, the HKMA would expect such individual to be appointed as an EO. Where such appointments result in less than two EOs for any regulated activity, the appointment of the remaining EO(s) should be based upon seniority. In other words, the EOs for each regulated activity should be the relevant individuals in the highest rank according to the RI's internal ranking. The HKMA expects that in most circumstances, for every regulated activity, each RI should have 2 EOs who are at most one rank below a manager (as defined in section 2 of the BO) of the RI.

Apart from this specific consideration, the HKMA will also take into account the size of the RI, the significance of the regulated activity in relation to the overall business of the institution, the management structure as well as the reporting line of the EOs in assessing whether they have sufficient authority in general.

Outcome of application

The processing of an application will normally be completed within ten weeks, provided that all necessary information and documents have been submitted by the applicant and subject to receiving feedback on background checks.

The HKMA may -

- give consent (with or without conditions attached) to an EO; or
- refuse an EO application in full or in part (i.e. refuse to give consent in respect of one or more of the regulated activities under application).

Where the HKMA gives consent to an EO application, it will as soon as is reasonably practicable give notice in writing to the individual concerned and the RI concerned, and specify any conditions attached to the consent. The notice will indicate the types of regulated activity for which such consent is given.

Where the HKMA decides to refuse an EO application, it will as soon as is reasonably practicable give notice in writing to the individual concerned and the RI concerned and specify the reasons.

To be in line with the SFC's procedures, if the HKMA decides to attach conditions to a consent to be given, or if it decides to refuse (in full or in part) to give consent, it will -

- give at least 7 days' advance notice to the EO applicant of the decision and the reasons for making such decision; and
- take into account any written representation received from the EO applicant,

before doing so.

Application for provisional consent

As stipulated in the new section 71E of the BO, upon request of an individual seeking consent under section 71C to be an EO, the HKMA may give provisional consent to the individual to be such EO. The HKMA shall refuse to give provisional consent unless the EO applicant satisfies the HKMA that the giving of such consent will not prejudice the interests of depositors or potential depositors of the RI concerned and the investing public.

After a provisional consent is granted, the formal consent will be given when the HKMA has satisfactorily completed the vetting procedures (i.e. background checks) in respect of the individual.

Submission of information in relation to EOs

By the nature of their engagement in regulated activities, EOs are relevant individuals and hence their specified particulars will be entered in the HKMA Register to be established and maintained under section 20 of the revised BO.

The HKMA Register will contain the same types of particulars for EOs and non-EOs, except that for every EO, there will be an indication of the regulated activities for which the individual is an EO.

The HKMA web-based online system (Online System⁴) for the submission of relevant individuals' particulars will not accept a RI's submission of information in relation to an EO⁵. All such submissions must be made in writing to the HKMA. The following points should be noted in this regard.

- a. The information contained in an EO application will be sufficient for the purpose of the HKMA Register. Upon granting consent, the HKMA will perform the system inputs for updating the HKMA Register. The RI concerned therefore does not need to make another submission in writing for such purpose.
- b. Before an EO may take up the responsibility of directly supervising any additional regulated activity(ies), a new consent from the HKMA must be obtained. He has to complete the application form for change of regulated activities (Form C(i)⁶) in **Annex 2** and go through the same procedures as a new application.
- c. Where an individual ceases to be an EO of any (but not all) regulated activities for a RI, the RI has to notify the HKMA using Form C(i) within 7 business days of such change.
- d. In respect of (b) or (c) above, the HKMA will issue a new consent letter

indicating the revised types of regulated activities for which such consent is given. This new consent letter will supersede all previous ones granted to the same individual in relation to the same RI.

- e. Where an individual ceases to be an EO for a RI, or in the case of other subsequent changes to the information relating to an EO that has been provided to the HKMA (whether for the purpose of the application for consent or after obtaining the HKMA consent), the RI must notify the HKMA within 7 business days of such changes.

Disciplinary actions in respect of EOs

All RIs and their EOs must note that where

- an EO is, or was at any time, guilty of misconduct; or
- the HKMA has ceased to be satisfied that an EO is a fit and proper person to be such officer or has sufficient authority within the RI concerned to be such officer,

the HKMA may, after consultation with the SFC, exercise its power under the new section 71C of the BO to withdraw or suspend its consent.

In addition, the HKMA may make recommendations to the SFC regarding the exercise of the latter's powers under section 196 of the SFO to impose any of the following disciplinary measures on the EO concerned -

- public or private reprimand;
- prohibition from applying for licence;
- prohibition from applying for approval as an EO of a RI or a responsible officer of a licensed corporation;
- prohibition from having his name entered in the HKMA Register; and
- ordering the paying of a pecuniary penalty.

The SFC and the HKMA are subject to the following statutory procedural requirements for the exercise of the above powers-

- before the exercise of any of such powers, the other regulator will be consulted and the individual concerned will be given a reasonable opportunity to be heard; and
- where a regulator decides to exercise the relevant power, the individual concerned will be informed of the decision by written notice.

In addition, an individual who is the subject of SFC or HKMA disciplinary decision has a right of appeal to the Securities and Futures Appeals Tribunal.

Under the new section 71C(13) of the BO and section 193(2) of the SFO, where a RI is guilty of misconduct as a result of the commission of any conduct occurring with the consent or connivance of, or attributable to any neglect on the part of, an EO of the RI, the conduct will also be regarded as misconduct on the part of the EO and "guilty of misconduct" will be construed accordingly.

It is essential for the senior management of RIs to draw to the attention of their EOs that they shall be personally and legally liable to these disciplinary sanctions if they are found guilty of misconduct or considered to be not fit and proper. It should also be noted that those involved in the management of regulated activities, whether EOs or not, may also be liable to disciplinary sanctions on the same basis as EOs.

Should you have any questions relating to this letter, please contact Miss Maisy Chang at 2878-1604 or Mr. Eric Fok at 2878-1538.

Yours faithfully,

D T R Carse
Deputy Chief Executive

¹ Refer to our circular "Register of relevant individuals to be maintained by the HKMA under the Banking (Amendment) Ordinance 2002" of 12 September 2002 for details of deemed RIs.

² For details of relevant individuals and the HKMA Register, refer to our circular "Register of relevant individuals to be maintained by the HKMA under the Banking (Amendment) Ordinance 2002" of 12 September 2002.

³ An exception is of course where an AI is already a RI and seeks to appoint further EOs.

⁴ Refer to our circular "New securities supervisory regime - Register to be maintained by the HKMA and Specific guidance in relation to relevant individuals" of 27 February 2003 for details of the Online System.

⁵ Where a relevant individual is concurrently an EO for one regulated activity and a non-EO for another, the information (including subsequent changes) on the latter type of regulated activity should however be submitted by the RI concerned through the Online System to the HKMA.

⁶ Form C(i) is also available on the HKMA's private website for AIs (www.hkfin.net).

Encl.: Annex1 (Available only to authorized institutions)
Annex2 (Available only to authorized institutions)

c.c.: The Chairman, HKAB
The Chairman, DTCA
SFC (Attn: Mrs Alexa Lam)

