

**Bills Committee on Securities and Futures and Companies
Legislation (Structured Products Amendment) Bill 2010**

**Legal Backing for the Regulatory Actions Taken by
the Hong Kong Monetary Authority on the Sale of
Unlisted Investment Products by Authorized Institutions**

Purpose

In the paper no. CB(1)968/10-11(04), the Hong Kong Monetary Authority (HKMA) provided information on the regulatory actions taken by it in relation to the sale of unlisted investment products by authorized institutions (AIs). The following paragraphs provide information on the legal backing for the regulatory actions mentioned in that paper.

Legal Backing

2. It is set out clearly in the Banking Ordinance (BO) that the Monetary Authority has an overall supervisory responsibility for all businesses of AIs. Under section 7(1) of the BO, the principal function of the Monetary Authority (MA) under the BO is to promote the general stability and effective working of the banking system. Section 2 of the BO provides that “functions” includes “powers and duties”. In addition, under section 7(2)(b) of the BO, the MA is required to take all reasonable steps to ensure that AIs operate in a responsible, honest and business-like manner. The MA is also required under section 7(2)(c) of the BO to promote and encourage proper standards of conduct and sound and prudent business practices amongst AIs, and under section 7(2)(d) of the BO to suppress or aid in suppressing illegal, dishonourable or improper practices in relation to the business practices of AIs. Moreover, section 7(2)(g) of the BO stipulates that the MA shall take all reasonable steps to ensure that any banking business, any business of taking deposits, or any other business, carried on by an AI is carried on (i) with integrity, prudence and the appropriate degree of professional competence; and (ii) in a manner which is not detrimental, or likely to be detrimental, to the interests of depositors or potential depositors.

3. For the purpose of performing the above-mentioned functions, the MA may use his powers under the BO and/or the Securities and Futures Ordinance (SFO). The MA may use powers under sections 55 and 56 of the BO and/or section 180 of the SFO to conduct on-site examinations of the sale of unlisted investment products by AIs. The

MA may issue statutory guidelines under section 7(3) of the BO. By virtue of section 7 of the BO, when read in conjunction with section 40 of the Interpretation and General Clauses Ordinance¹, the MA issues circulars to enhance the regulatory requirements and/or provide guidance to AIs on the regulatory standards and expected practices, performs mystery shopper programme on the practices of AIs in selling unlisted investment products, and requires AIs to take appropriate actions in relation to any deficiencies in their internal controls that are discovered in the HKMA's on-site examinations or other sources.

4. Pursuant to the MA's power under section 63 of the BO to require AIs to submit (including periodically submit) returns covering information on assets and liabilities, profit and loss, etc., and information as he may reasonably require for the exercise of his functions under the BO, the HKMA has taken the following regulatory actions –

- (a) required the 17 AIs concerned to submit information in relation to their implementation of the respective independent reviewer's recommendations as a result of the independent review of the internal controls in relation to the sale of unlisted structured products, which the AIs concerned were required to engage an independent reviewer approved by the regulators to conduct under the respective settlement agreements among these AIs, the HKMA and the Securities and Futures Commission (SFC)²;
- (b) required AIs to submit the semi-annual "Return of Securities Related Activities";
- (c) required AIs to submit results of self-assessments on their compliance with relevant regulatory requirements;
- (d) required AIs to submit information in the form of surveys; and
- (e) required AIs to submit information in relation to

¹ Section 40(1) of the Interpretation and General Clauses Ordinance provides that where any ordinance confers upon any person power to do or enforce the doing of any act or thing, all such powers shall be deemed to be also conferred as are reasonably necessary to enable the person to do or enforce the doing of the act or thing.

² The HKMA and the SFC had the right to approve independent reviewers and receive reports from these reviewers in accordance with the terms of engagement of such independent reviewers as prescribed by the settlement agreements.

deficiencies in their internal controls and the actions taken or planned to be taken by the AIs in this relation.

5. Further, AIs are required to meet the minimum criteria for authorization set out in the Seventh Schedule to the BO. Such criteria are continuing in nature. Failure to meet the criteria by existing AIs would be a ground for revocation of authorization. Paragraphs 4 and 5 of the Seventh Schedule provide, inter alia, that the MA must be satisfied that each person who is, or is to be, an executive officer is a fit and proper person to hold that position. Under paragraph 10 of the same Schedule, the MA must be satisfied that AIs have adequate accounting systems and adequate systems of control. Under paragraph 12 of the 7th Schedule, the MA must be satisfied that business of AIs (including any business which is not banking business or the business of taking deposits) is carried on (i) with integrity, prudence and the appropriate degree of professional competence; and (ii) in a manner which is not detrimental, or likely to be detrimental, to the interests of depositors or potential depositors. In considering whether an AI satisfies the above requirements under the Seventh Schedule, the HKMA would have due regard to, among other relevant factors, the AI's compliance with the relevant regulatory requirements imposed by the HKMA and the AI's actions as required by the HKMA in relation to the AI's systems of control and conduct of business.

Hong Kong Monetary Authority
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