

LEGAL UPDATE

Hong Kong SFC clarifies competence requirements for existing licensed persons intending to provide asset management services

On 23 June 2017, the Securities and Futures Commission of Hong Kong (the “SFC”) issued the “Circular to clarify competence requirements for existing licensed persons intending to provide asset management services” (the “Circular”), with an aim to provide further guidance on how the SFC assesses the competence of a corporation or a responsible officer (“RO”) to carry on asset management activities.

The Circular focuses on the eligibility criteria for licensed persons to be approved to carry out Type 9 regulated activity of asset management with respect to industry experience that may be relevant and acceptable, and also on the conditions for seeking exemptions from passing the required local regulatory papers.

As the title of the Circular suggests, it is directed to existing licensed persons that may consider expanding their scope of business into asset management. In a press release on the Circular, the SFC’s expresses that it welcomes existing licensees to broaden their business scope in light of the growth in Hong Kong’s asset management industry.

Background

Incidental Exemption

Under the Securities and Futures Ordinance (Cap. 571 of the laws of Hong Kong) (“SFO”), licensed persons (corporations and/or individuals) may rely on an exemption from holding a license for certain types of regulated activities if such activities are performed wholly incidental to the activities for which they are already licensed (the “**Incidental Exemption**”).

A usual Incidental Exemption is where a corporation licensed for Type 1 regulated activity of dealing in securities carries out discretionary investment management wholly incidental to the securities dealing business. Such exemption usually applies to stock brokers who provide investment advice or manage discretionary accounts for their securities clients, who would then not be required to also hold a license for conducting Type 9 regulated activity of asset management. Under the SFO, “asset management” is defined to mean (a) real estate investment scheme management, or (b) securities or futures contracts management. Similarly, a futures broker licensed for Type 2 regulated activity of dealing in futures contract may engage in discretionary management of client’s futures brokerage investments where this is wholly incidental to its services for the client’s futures brokerage account.

If such corporation wishes to expand its business to asset management activities beyond the Incidental Exemption, such corporation and its ROs will be required to apply for a separate Type 9 regulated activity (asset management) license (the “**Applicant**”).

Overview on Competence Requirement

(i) Competence Requirement for Corporations

Generally, a licensed corporation will need to have proper business and governance structure, good compliance and internal control systems and qualified personnel for the proper management of risks when carrying on its business. Similar to other regulated activities, each corporation licensed for Type 9 regulated activities is required to have at least 2 ROs to supervise its business, one of them being an executive director.

SFC will consider the overall competence of a corporation and its ROs in assessing whether the corporation and its ROs are fit and proper to be licensed to conduct the business in the relevant regulated activity, and considering relevant conditions that may be imposed to limit the scope of business activities.

(ii) Competence Requirement for Responsible Officers

By virtue of section 116(3) of the SFO, the SFC shall refuse to grant a license to the Applicant unless he/she has satisfied to the SFC that he/she is fit and proper. As part of the fit and proper requirement, a RO Applicant should fulfil competence requirements, which is assessed through four key elements whether he/she can properly manage and supervise the licensed corporation's regulated activities, which are with respect to his/her

- (1) academic/industry qualification,
- (2) industry experience,
- (3) management experience and
- (4) regulatory knowledge.

The Circular

The Circular provided specific clarifications on the industry experience that may be considered as relevant for seeking additional license to conduct the Type 9 regulated activity of asset management, and also the applicable conditional exemptions from passing the required examination papers regarding regulatory knowledge.

Relevant Industry Experience

In respect of a potential RO Applicant, according to the Circular, the SFC will take into account the Applicant's accumulated career history in the financial industry when considering whether he or she meets the experience requirement.

For instance, where the RO Applicant is currently licensed to carry out Type 1 regulated activity of dealing in securities, and is currently allowed to conduct asset management activity which is wholly incidental to his or her conduct of dealing activity, such as discretionary account management, the SFC will consider such experience as relevant when considering his/her RO application for Type 9 regulated activity of asset management.

The SFC also refers to other industry experience such as investment research, private equity and proprietary trading, as relevant industry experience that the SFC also recognizes and will consider in assessing an Applicant. In this regard, the SFC made reference in the Circular to an earlier circular, “SFC Adopts a Pragmatic Approach to Licensing Fund Managers”, which was issued in 2007. At that time the said 2007 circular was directed at overseas fund managers to clarify the pragmatic approach of the SFC to make the licensing process easier and more streamlined for overseas hedge fund managers, in particular managers already licensed or registered in the United States or in the United Kingdom could benefit from an expedited licensing process.

The Circular reiterates that the SFC would take into account an individual’s broader range of investment-related experience.

Regulatory Knowledge - Local Regulatory Framework Paper Requirement

Under the element of regulatory knowledge, the RO Applicant has to obtain a pass on certain local regulatory framework papers (the “**LRP Requirement**”). However, under specific circumstances, the SFC has the discretion to exempt the RO Applicant from the LRP Requirement.

The table below shows 2 illustrative examples as provided in the Circular, under which the SFC may grant an exemption of the LRP Requirement to the RO Applicant and the conditions imposed on the permitted activities:

	<i>Applicant A</i>	<i>Applicant B</i>
Circumstances	<i>Intending to manage discretionary accounts only</i>	<i>Intending to manage private investment funds</i>
Minimum Experience	<ul style="list-style-type: none"> - an existing responsible officer for Type 1 regulated activity (dealing in securities); and - has five or more years of related experience in managing discretionary accounts over the past eight years 	<ul style="list-style-type: none"> - has over eight years of industry experience in recognised local or overseas markets; <i>or</i> - is already registered or licensed in the United Kingdom or the United States for investment management or advisory business
Exemption on the LRP Requirement is granted <u>on the condition that:</u>		
Restriction on permitted activities	<ul style="list-style-type: none"> - only be allowed to engage in discretionary account management; - if the applicant also serves as a Manager-In-Charge of the Overall Management Oversight function of a licensed corporation, the corporation will be subject to the same restriction. 	<ul style="list-style-type: none"> - only be allowed to be accredited to a licensed corporation which only serves professional investors in respect of its Type 9 (asset management) business.
Professional training requirements	<ul style="list-style-type: none"> - the RO Applicant must complete an additional five continuous professional training (CPT) hours on local regulatory knowledge of Type 9 regulated activity (asset management) within 12 months after approval unless he or she has already completed the same within six months preceding the application; - CPT hours on general market or regulatory knowledge are unlikely to be accepted by the SFC as meeting this requirement. 	

While the above examples are provided in the Circular as illustration of the SFC's discretion in allowing an exemption from the LRP Requirement, these are not exhaustive.

Indeed, as stated in the SFC's *Guidelines on Competence* (issued March 2003):

- the objective of requiring individuals engaged in regulated activities to pass the regulatory exam is to ensure that they are aware of their legal responsibilities as well as potential liabilities;
- the SFC may at its sole discretion consider granting exemption to an individual from passing the local regulatory framework paper if he can demonstrate that he possesses comparable qualifications, and the SFC will review and consider all relevant facts and circumstances presented in a pragmatic manner in granting the exemptions. Some criteria are outlined in Appendix E of the Guidelines on Competence.

Remarks

The Circular also emphasizes that the SFC will consider each application for exemption based on the specific circumstances of each case and that interested firms are encourage to approach the SFC to discuss their proposed business plans.

The Circular can be seen as the SFC's effort to inform the industry that the SFC will continue to take a pragmatic approach in considering licensing applications, and spells the SFC's intention to encourage existing licensed entities to apply to engage in Type 9 regulated activity of asset management as a stand-alone business, to spur further growth of Hong Kong's asset management industry.

Considering the mention of the broader industry experience that the SFC would take into account including investment research, private equity and proprietary trading, as well as industry experience in other recognized local or overseas markets (being those listed in Parts 2 and 3 of Schedule 1 to the SFO, covering many securities and futures exchanges around the world), the Circular also suggests the SFC's welcome attitude for qualified and experienced investment professionals around the globe to seek to be licensed in Hong Kong to engage in asset management.

Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual contact at our firm.

Vivien Teu Partner Vivien Teu & Co LLP Tel: (852) 2969 5316 vivien.teu@vteu.co	Christina Suen Senior Associate Vivien Teu & Co LLP Tel: (852) 2969 5362 christina.suen@vteu.co
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