



Hong Kong

June 2017

SFC CIRCULAR ON RESPONSIBLE OFFICERS AND SUBSTANTIAL SHAREHOLDERS

The Securities and Futures Commission (**SFC**) has issued a circular to licensed corporations on responsible officers and substantial shareholders¹ (the **Circular**), reminding licensed corporations that it is not acceptable to hire responsible officers in name only, where the relevant persons do not in fact supervise the licensed corporation's business. The Circular also informs prospective acquirers of licensed corporations that the assessment and vetting process for a new substantial shareholder applicant is equally as stringent as that for a new licensed corporation application, particularly where the licensed corporation in question appears to be dormant. This reflects the SFC's concerns about an increasing trend of licensed corporations being acquired or set up by persons without prior experience in the securities industry and reports of large premiums being paid for inactive licensed corporations and of the hiring of responsible officers who do not participate in the licensed corporation's management or operations.

The SFC reiterates its ability to revoke the licences of corporations and individuals who do not genuinely carry on a business in a regulated activity. This phenomenon was referred to as "backdoor licensing"² in our newsletter of 26 May 2017.

Duties and Applications of Responsible Officers

Responsible officers must have sufficient authority to supervise the business of the regulated activity for which they are approved. It is not acceptable to hire responsible officers

- <http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=17EC32>
- <https://www.charltonslaw.com/backdoor-licensing-managers-in-charge-of-core-functions-and-the-legal-liabilities-of-senior-management/>

in name only; they must participate in the supervision of the licensed corporation's business. Otherwise, there will be doubt as to whether the licensed corporation's senior management is properly supervising its regulated activities, and the SFC may regard the licensed corporation and its responsible officers to be not fit and proper. This could lead to disciplinary action, including public reprimand and licence revocation.

In an application for approval as a responsible officer, an applicant should describe his or her proposed specific duties concerning their supervision of the business of the licensed corporation. When necessary, the SFC may contact the responsible officer directly to confirm his or her area of responsibilities and the business of the licensed corporation under his or her supervision. If it is discovered that a responsible officer does not in fact participate in the supervision of the licensed corporation's business, the licensed corporation and the responsible officer may have committed an offence of providing false or misleading information to the SFC in their licence applications.

To determine whether an applicant is fit and proper to be licensed as a responsible officer, the SFC will take into account the amount of time he or she is able to dedicate to carrying out the duties of a responsible officer. Consideration would also be given to whether the person can properly manage any potential conflicts of interest arising from his or her other capacities and/or business interests. Thus, it is unlikely that an individual will be considered to be fit and proper to be licensed to act for more than one licensed corporation, unless the licensed corporations are in the same corporate group or owned by the same controlling shareholders. A conflict

of interest may also arise if the responsible officer acts as a director, external consultant or compliance adviser for other licensed corporations or applicants.

Changes in Substantial Shareholder

The SFC's prior approval is required for any company or individual to become a substantial shareholder of a licensed corporation.³ A person will be a substantial shareholder of a corporation if he or she, either alone or with associates:

1. has an interest in shares of the corporation:
 - i) equal to more than 10% of the corporation's issued shares; or
 - ii) which entitles the person, either alone or with any of his associates and either directly or indirectly, to exercise or control the exercise of more than 10% of the voting power at general meetings of the corporation; or
2. holds shares in any other corporation which entitles him, either alone or with any of his associates and either directly or indirectly, to exercise or control the exercise of 35% or more of the voting power at general meetings of the other corporation, or of a further corporation, which is itself entitled, either alone or with its associates and either directly or indirectly, to exercise or control the exercise of more than 10% of the voting power at general meetings of the corporation.⁴

The Circular notes that the assessment and vetting process for a change in the substantial shareholders of an existing licensed corporation is no less stringent than that for new applicants for a corporate licence. This is to ensure that an acquisition of an existing licensed corporation cannot be used as a means to avoid the assessment and vetting process that new corporate licence applicants must undergo. The time required to approve substantial shareholders is also likely to be comparable to that of a new corporate licence application, which takes about 15 weeks according to the SFC's performance pledge.⁵ Where a licensed corporation appears to be dormant, the SFC will give particularly close scrutiny to any application for approval to become a substantial shareholder of that licensed corporation.

An application to become a substantial shareholder may be refused if the SFC does not believe that the licensed corporation will remain fit and proper after the approval is granted. The SFC may also enquire into the substantial shareholder's source of funding and financial strength in order to assess the legitimacy of the funds and to confirm that any ultimate beneficial owners who are substantial shareholders have applied for approval.

The SFC will assess any potential changes to the business plan and senior management of the licensed corporations after a change of ownership. Licensed corporations must inform the SFC of certain changes, including significant changes to their business plan and changes to their senior management, within seven business days.⁶ The SFC may seek to confirm what changes have actually occurred in order to make sure that parties are forthcoming in providing information. It should be noted that providing false or misleading information to the SFC constitutes an offence punishable by a fine and imprisonment.

For further information, please see our newsletter on "Backdoor licensing", the requirements for Managers-in-Charge of Core Functions and the legal liabilities of senior management.⁷

³ Section 131 of the SFO.

⁴ Section 6 of Schedule 1 to the SFO.

⁵ <http://www.sfc.hk/web/EN/about-the-sfc/corporate-governance/performance-pledges.html>

⁶ The Securities and Futures (Licensing and Registration) (Information) Rules and the Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management issued 16 December 2016.

⁷ <https://www.charltonslaw.com/backdoor-licensing-managers-in-charge-of-core-functions-and-the-legal-liabilities-of-senior-management/>

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