

SFC's "Manager-In-Charge" regime - a new reform to embrace ?

On 16 December 2016, the Securities and Futures Commission ("SFC") published, in a circular (<http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=16EC68> and annexes <http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openAppendix?refNo=16EC68&appendix=0>), new measures to heighten the accountability of senior management of all licensed corporations. To industry participants, it may be a complex regime which brings uncertainty and challenges. To the SFC, it may be a practical way to drive proper behaviour and achieve better investor protection in light of the rapid industry growth.

The new regime introduces new definition of "*senior management*" and identification of eight "*Core Functions*" which are essential to the operation of licensed corporations.

"Senior management"

Other than directors and Responsible Officers ("**RO**"), who have already been deemed senior management of a licensed corporation, the SFC introduced a new group known as "*manager-in-charge*" ("**MIC**"). The SFC clarifies that these three groups are not mutually exclusive, i.e. one individual can simultaneously take up more than one of the roles.

"Manager-in-charge" & "Core Functions"

So who is a MIC? It refers to an individual appointed by a licensed corporation to be principally responsible, either solely or jointly with others, for managing any of the following eight Core Functions of the corporation:

- (i) Overall Management Oversight
- (ii) Key Business Line
- (iii) Operational Control and Review

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CONTACT



Philson W. H. HO

Partner,
financial services
regulatory and litigation
Hong Kong
+852 3896 2619



Mboma W. K. YEUNG

Associate,
financial services
regulatory and litigation
Hong Kong
+852 3896 2617



Natalie C. H. LAM

Associate,
financial services
regulatory and litigation
Hong Kong
+852 3896 2645

- (iv) Risk Management
- (v) Finance and Accounting
- (vi) Information Technology
- (vii) Compliance
- (viii) Anti-Money Laundering and Counter-Terrorist Financing

The detailed descriptions of which can be found in the link of annexes to the said circular abovementioned.

For each Core Function, at least one individual has to be appointed as a MIC. However, to allow flexibility for organisational structures, there is no restriction on the maximum number of MICs for a single Core Function or the number of Core Functions that a MIC can take charge of.

The SFC expects that MICs of the Overall Management Oversight function and the Key Business Line function should generally be ROs in respect of the regulated activities they oversee since the MICs responsible for these Core Functions will likely be required to actively participate in or be responsible for directly supervising the business of the regulated activities.

MICs may be located in Hong Kong or overseas. They do not have to be employees of the licensed corporation or, depending on the particular Core Function, be licensed under the Securities and Futures Ordinance (“SFO”). However, they must hold positions of sufficient authority within the licensed corporation e.g. the authority to make decisions, allocate resources and represent a particular department etc. Hence, external parties merely providing outsourcing services are not qualified.

It is expected that MICs should be accountable for the performance or achievement of business objectives and should report directly to either the Board of the corporation or the MIC who assumes the Overall Management Oversight function.

Presently, no regulatory approval has to be obtained before a MIC is appointed. However, licensed corporations are reminded to ensure that the MIC is fit and proper and qualified to act in the capacity so appointed.

Standard of conduct expected of senior management

There are various SFC codes and guidelines providing guidance on the responsibilities of senior management of licensed corporations, in particular, General Principle 9 and paragraph 14.1 of the Code of Conduct, the Internal Control Guidelines and the Guideline on Anti-Money Laundering and Counter-Terrorist Financing. Licensed corporations should take note of these guidelines and expectations as they are now equally applicable to MICs in addition to ROs and directors.

Legal liabilities

Under Part IX of the SFO, the SFC is empowered to exercise its disciplinary powers to sanction a regulated person if the person is, or was guilty of misconduct or is considered not fit and proper to be or to remain the same type of regulated person. Such a “*regulated person*” includes not only (i) a licensed person, (ii) a RO, but also (iii) a person (licensed or not) involved in the management of the business of a licensed corporation, which includes the newly introduced MICs.

Where a licensed corporation is (or was) found 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, a MIC, then that MIC can also be found guilty of misconduct (section 193(2) of the SFO).

In general, the disciplinary sanctions which the SFC may impose, e.g. payment of pecuniary penalty, on a regulated person under Part IX of the SFO are civil in nature. However, senior management of licensed corporations should also be aware of potential criminal liability. When a corporation has been found guilty of an offence under the SFO and the offence is proved to have been aided, abetted, counselled, procured or induced by, or committed with the consent or connivance of, or attributable to any recklessness of, any officer of the corporation, then that officer is also guilty of the offence (section 390(1) of the SFO).

Management structure & submission of organisational chart

The SFC expects that the management structure of the corporation, including the appointment of MICs, their roles, responsibilities,

accountability and reporting lines be approved and clearly set out by the Board in a formal document. Meanwhile, the Board should ensure that each MIC has acknowledged the appointment as MIC and the particular Core Function(s) for which the individual is principally responsible for.

Further, when applying for a licence under section 116(1) of the SFO, a corporation is required to provide information about its human resources and organisational structure showing that it is capable of carrying on regulated activities competently, including particulars of its proposed MICs and organisation charts.

While the commencement of this information collection initiative will be on 18 April 2017, the SFC expects licensed corporations to submit the newly required information within 3 months of the commencement date, i.e. by 17 July 2017. More importantly, the SFC generally expects that MICs of the Overall Management Oversight function and the Key Business Line function, who are not already ROs, will have applied for approval to become ROs by 16 October 2017.

Concluding remarks

The new regime represents a significant regulatory shift with a specific aim to enhance the accountability of senior management of licensed corporations. Given the tight implementation timeframe and uncertainty of actual application, it is anticipated that licensed corporations will be facing various challenges. The MIC regime allows flexibility in management structure yet time is required to see how it applies in practice. Licensed corporations will need to think carefully before appointment of MICs to ensure that they possess the relevant authority in relation to the Core Function(s) the individual is primarily responsible for whilst at the same time may consider appointing offshore MICs for handling multiple Core Functions. In particular, global organisations which do not have senior managers for all Core Functions in Hong Kong and boutique licensed corporations which have simple and multi-functional organisational structures will have to tailor structural changes in order to meet with the new requirements by the SFC during the transitional period.

Furthermore, the new regime introduces individual liability of MICs. Whilst the SFC has clarified that the standards expected of MICs are

already contained in the existing codes and guidelines, they are not clearly defined and understood by industry participants. In particular, it remains questionable if the same standards should equally apply to all MICs, some of which may not even be licensed, in light of the context of their specific roles.

End.

Our financial services regulatory and litigation team provides practical legal and regulatory advice to Securities and Futures Commission (“SFC”) licence applicants, SFC licensed firms, banks and listed companies (as well as their directors and management staff).

We have solid experience in advising clients on SFC licensing obligations/exemptions, seeking various types of SFC/HKMA licences and registrations (e.g. securities, futures, FX, advisory, ATS, corporate finance and fund management licences), advising clients on daily legal and compliance obligations, and dealing with legal/regulatory issues which may arise from clients’ businesses from time to time.

On the litigation aspect, we handle enquiries and investigations by securities regulators and government authorities. Examples are investigations and court proceedings brought by the SFC, the Hong Kong Monetary Authority, the Hong Kong Stock Exchange, the Police and the Independent Commission Against Corruption. We also handle other commercial litigations such as shareholders’ disputes, employment disputes, contractual disputes and “mis-selling” claims.

We have solid experience in defending listed companies’ directors (on insider dealing and other market misconduct offences), securities brokerage firms, warrant market makers, securities analysts, investment banks and retail banks.

The team is led by Mr. Philson HO (Partner), a lawyer and certified public accountant who has more than 20 years of experience in legal, compliance, finance, audit and listed companies’ regulations. A former litigation partner of a major international law firm in Hong Kong, Mr. HO used to work in the SFC mainly responsible for licensing and compliance of Hong Kong financial services intermediaries.

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