# Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management

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**Of Relevance to:**
Hong Kong Licensed Firms

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## 1. Summary

On 16 December 2016 the SFC issued the Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management ("Circular")[1] setting forth the requirements for the new Manager-In-Charge requirements ("MIC Rules"). The MIC Rules come into effect on **18 April 2017** and Licensed Corporations are required to comply by submitting to the SFC certain required information about their MICs and organisation structure by **Monday, 17 July 2017**. The MIC Rules are intended to provide the SFC with a more complete understanding of the organization, a Licensed Corporation's senior management and allocation of responsibilities for key functions amongst them. This requirement is consistent with comparable rules in other jurisdictions the SFC seeks to emulate[2].

## 2. The Requirements

### 2.1. Core Functions

The MIC Rules delineate eight core functions ("MIC Functions") which underpin a Licensed Corporation's business and require specific designation to the SFC of an individual appointed thereby ("MIC") for its management, as follows:

(i) Overall Management Oversight, which person must be a Responsible Officer
(ii) Key Business Line(s), which person(s) must be a Responsible Officer
(iii) Operational Control and Review
(iv) Risk Management
(v) Finance and Accounting
(vi) Information Technology
(vii) Compliance
(viii) Anti-Money Laundering and Counter-Terrorist Financing3

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[1] The Circular can be downloaded at http://www.sfc.hk/edistributionWeb/gateway/EN/circular/openFile?refNo=16EC68 and the FAQ to the Circular at http://www.sfc.hk/web/EN/faqs/intermediaries/licensing/manager-in-charge-regime.html.
[2] For example, the Senior Managers and Certification Regime in the UK commencing earlier this year.
[3] Circular, Paragraph 7; refer to Annex 1 to the Circular for the SFC's definition of each MIC role.

### 2.2. Manager-in-Charge

The Circular specifies that when determining who is the most appropriate person for each MIC Function, one must consider the apparent and actual authority of that person in relation to the function, specifying four attributes to be employed in making this determination. The individual selected:

(i) Occupies a position within the Corporation which is of sufficient authority to enable the individual to exert a significant influence on the conduct of that Core Function;

(ii) Has authority to make decisions (*e.g.*, assume business risks within pre-set parameters or limits) for that Core Function;

(iii) Has authority to allocate resources or incur expenditures in connection with the particular department, division or functional unit carrying on that Core Function; and

(iv) Has authority to represent the particular department, division or functional unit carrying on that Core Function, *e.g.*, in senior management meetings or in meetings with outside parties.[4]

The Circular indicates the SFC expects that MICs will:

(i) Report directly to the Board of the Corporation, or to the MIC who assumes the Overall Management Oversight function of the Corporation; and

(ii) Be accountable for the performance or achievement of business objectives set by the Board, or by the MIC who assumes the Overall Management Oversight function.[5]

The SFC indicated that, consistent with its interpretation of the various Codes, Guidelines and Circulars it issues, it will adopt a principles-based approach to Licensed Corporation's compliance with the MIC Rules. For example, the Circular provides the SFC recognises that small and recently established Licensed Corporations will not have the resources to appoint a dedicated MIC for each MIC Function and will permit a single individual to serve in multiple roles[6] for those MIC Functions not requiring a Responsible Officer.[7] Similarly, the SFC advises that it recognises large firms with global offices may have MIC(s) based overseas, and further, that such persons need not be employees of the Licensed Corporation provided they hold positions of authority within the firm and remain accountable to its Board of Directors ("Board").[8] The Circular clearly indicates that MICs cannot be external service providers.[9]

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4 Circular, Paragraph 9.

5 Circular, Paragraph 10.

6 The SFC has not given specific guidance on which MIC Functions could be supervised by a single MIC; it is anticipated they would be those functions which readily lend themselves to supervision by one individual, *e.g.*; (i) Operational Control and Review together with Risk Management; and (ii) Compliance together with Anti-Money Laundering and Counter-Terrorist Financing.

7 Circular, Paragraph 8; FAQ, Items 9-11, 31.

8 Circular, Paragraph 12.

9 *Ibid.*

## 3. Compliance

### 3.1. On or prior to 17 July 2017

#### I. SFC Reporting

As indicated above, the Licensed Corporation must submit to the SFC the following information for the MIC appointed for each of the MIC Functions via the SFC Online Portal ("Portal")[10]:

a) Full name;

b) Identification information;

c) Job title[11];

d) Place of residence;

e) The Core Function(s) which manages; and

f) The job title(s) of the person(s) to whom he reports within the Corporation and, if applicable, within its corporate group.

The foregoing must be provided together with an organizational chart referencing all MICs and showing the Licensed Corporation's management and government structure, business and operational units and their respective reporting lines.

#### II. Internal Documentation

The SFC advises it expects each Licensed Corporations' Board to adopt a formal document setting forth the above information, which should be amended as these items change[12] and that it may request a Licensed Corporation to provide them with a copy.[13] Consistent with its principles-based approach, the SFC has indicated that it does not mandate any particular organisational or governance structure for compliance with this element of the MIC Rules.[14]

#### III. Thereafter

Consistent with other Licensed Corporation and Licensed Representative reporting requirements, any changes to the MICs or their particulars (as indicated above in item A.1 (a)-(f) and other material amendments to a Licensed Corporation's organisation chart must be reported to the SFC within seven business days of any change. In addition, changes of personnel serving as MICs and changes in Licensed Corporations' reporting lines must be approved by the firm's Board.

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[10] SFC Online Portal: https://portal.sfc.hk/sfcportal/signin?locale=en.

[11] The job title should indicate an individual's position and particular business or operational area (*e.g.*, Chief Executive Officer, Chief Investment Officer, Chief Administrative Officer, Head of Risk Management, Head of Corporate Finance).

[12] FAQ, Items 38-39.

[13] Circular, Paragraph 28. As a certainly, the SFC will request a copy of this document prior to commencing a prudential visit or on-site audit. Firms which presently have an initial SFC license application in process will more likely be required to provide this document.

[14] Circular, Paragraph 11.

## 4. Implications

Upon an initial review of the Circular, compliance with the MIC Regime appears relatively straightforward by way of submitting to the SFC prior to the stipulated deadline the MIC information, together with an organisation chart showing MICs and their reporting lines via the Portal. However, careful consideration must be made regarding designation of MICs and due care must be undertaken to ensure that each individual fully understands the implications of assuming this role. For Licensed Corporations owned and/or supported by overseas entities, significant consideration of existing operational structures and reporting lines must be undertaken within a relatively short period of time.

### 4.1. Legal liability

The Circular makes clear that MICs are subject to the same legal liability as that of any Licensed Representative or Responsible Officer and accordingly are subject to the same disciplinary powers provided by Part IX of the Securities and Futures Ordinance.[15] In effect, actions of senior management, which presumably includes senior management which are not designated MICs, will be subject to the same "fit and proper person" standard applied to licensed employees, and similarly will be subject to the same liability.[16] MICs and potentially all senior management must understand the scope of their role within the Licensed Corporation and the Licensed Corporation must adopt a documentary framework to evidence their appointment as such. To date SFC has only very infrequently commenced enforcement actions against persons who are not licensed thereunder. The MIC Regime indicates the SFC's willingness to broaden corporate accountability to now include legal liability for senior management[17] who are not SFC licensed.

### 4.2. Fitness and Properness

The MICs for six of the eight Core Functions not directly concerning supervision of a Regulated Activity need not be SFC licensed, but must be fit and proper. Licensing of Licensed Representatives (which includes Responsible Officers) has always been on the basis of the candidates' satisfaction of fitness and properness criteria, as set forth in elemental SFC Codes and Guidelines[18]. Following on the point in the above paragraph, the SFC has not, however, given any the definition of fitness and properness as applied to MICs which are not licensed or overseeing Regulated Activities, and the SFC Codes and Guidelines the SFC references are drafted so as to be applicable only to licensed persons.

### 4.3. Board of Directors

The MIC Rules are predicated on accountability and governance by a legal entity, which is managed by that entity's Board. This simplistic view of the functional organisation of a firm's operations fails to consider structures employed by the Hong Kong offices of larger global firms which may not

[15] Circular, Section E.

[16] The Circular and FAQ reference responsibilities of the MIC, whereas §197(7)(c) of the SFO indicates that a regulated person includes "a person involved in the management of the business of a Licensed Corporation". The SFC has not provided clarity on this point.

[17] Presumably, this will be determined by the Hong Kong courts in due course following the SFC's first prosecution of an MIC not required to be licensed.

[18] Circular, Paragraph 14; FAQ, Items 19. Each referencing General Principle 9 and Paragraph 14.1 of the *Code of Conduct for Persons Licensed by Securities and Futures Commission*, and the entirety of the *Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission*.

entrust their Hong Kong Board with responsibility for oversight of certain MIC Functions and which are in fact carried out and/or overseen by different legal entities based outside Hong Kong[19]. While this arrangement is not prohibited; firms employing this structure will need to consider amending the reporting lines for certain MICs based overseas or employed by a different legal entity so as to demonstrate their decision-making authority over, and accountability to, the Licensed Corporation's board.

The Circular also sets forth the SFC's view that every member of the Board, both executive and non-executive, is required to exercise independent judgment in relation to its powers over the Licensed Corporation and remains ultimately accountable for all aspects thereof[20]. Accordingly, Licensed Corporations having non-executive Board members not materially involved in the day-to-day exercise of oversight must ensure they understand their added responsibilities provided by the MIC Rules and in some cases reconsider the current Board membership.

## 5. Next Steps

Licensed Corporations should immediately: (i) commence a review of their organisational structure, senior management roles, reporting lines and senior employees and begin considering how to map the organisation of their operating units to the MIC Functions[21]; (ii) commence identification of appropriate individuals for each of the MIC Functions; (iii) if not already written, prepare an organisational chart incorporating the MICs and the roles, responsibilities, and reporting lines of them and its other senior management personnel; and (iv) following the finalisation of this document, obtain approval therefore by the firm's Board of Directors.[22]

## 6. Key dates

**17 July 2017:** Licensed Corporations must submit their MIC information and the organisation chart via the SFC Online Portal before this date

## How Can We Help?

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[19] The Circular provides no guidance on this point, it is hoped the SFC's will apply its principles based approach to Licensed Corporations' and their group companies' compliance with this requirement.
[20] Circular, Paragraph 27.
[21] Refer to Annex 1 to the Circular, showing the SFC's definition of each MIC role.
[22] Circular, Paragraphs, 28 – 29.