

Guidance Note on Competence

Hong Kong

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Purpose

1. This Guidance Note sets out the matters that the Commission will normally consider in assessing whether a person is competent to perform the functions of a licensed person. It applies to all corporations and natural persons licensed or applying for a licence under the Securities Ordinance (“SO”), the Commodities Trading Ordinance (“CTO”) and the Leveraged Foreign Exchange Trading Ordinance (“LFETO”).
2. This Guidance Note does not have the force of law. It is an elaboration on the Fit and Proper Criteria. It should not be interpreted in any manner which would override the provisions of any applicable laws, codes or other regulatory requirements. Failure to meet the expectations set out in this Guidance Note may raise concerns as to whether a person is fit and proper to be licensed.

Introduction

3. Under section 23 of the Securities and Futures Commission Ordinance (“SFCO”), section 121G and 121H of the SO and section 7 of the LFETO respectively, the Commission is obliged to refuse to grant a licence unless the applicant satisfies the Commission that they are fit and proper to be licensed. The matters that shall be considered in assessing fitness and properness include:
 - (a) financial status;
 - (b) educational or other qualifications or experience having regard to the nature of the functions to be performed;
 - (c) ability to perform such functions efficiently, honestly and fairly; and
 - (d) reputation, character, financial integrity and reliability.

4. The Fit and Proper Criteria, published by the Commission, sets out the Commission’s general expectation of what is necessary to satisfy the licensing requirements that an applicant or licensee is fit and proper. Among the requirements are paragraphs 3.3(f) and 3.4(g) which state that corporations and individuals applying for licences will generally not be considered fit and proper unless they can demonstrate that they are competent to perform their functions efficiently and effectively.

5. Paragraph 5.2 of the Fit and Proper Criteria provides that the SFC will consider revoking or suspending a licence if the licensed person is no longer fit and proper. In this regard, a licensed person is expected to remain competent in order to remain licensed.

Assessment of Competence

6. An applicant applying for a licence will be expected to demonstrate competence by showing the knowledge, skill and ability necessary to discharge the functions as a licensed person effectively and efficiently. A licensed person is expected to remain competent at all times.
7. The expectations set out in this Guidance Note are not exhaustive.
8. An applicant may be able to satisfy the Commission that they are fit and proper to be licensed even when they cannot satisfy the particular expectations set out in this Guidance Note.
9. Without compromising investor protection, the Commission will administer the competence criteria flexibly. For applicants or licensees that are businesses, it will take into account the size and the nature of the business and accept alternate arrangements, whether in Hong Kong or elsewhere, be it at local company or group level, that are likely to achieve the objectives of effective management of risk and satisfactory internal controls. Similarly, for applicants or licensees who are individuals, the Commission will take into account the applicant's responsibility, position within the organisation, and qualifications or experience gained locally or overseas.
10. For the purposes of this Guidance Note, corporate licensees refer to businesses carrying on licensed activities and include sole proprietors, corporations and partnership. Individual licensees refer to directors¹ or representatives who are required to be licensed under the relevant Ordinances.

¹ These are : directors under sections 48 and 49 of the SO, approved directors under section 121I of the SO, directors under sections 26 and 27 of the CTO and responsible directors under section 8 of the LFETO

Corporation

Entry Assessment

11. For corporate applicants, competence must be considered by reference to the applicant's organisational structure and the combined competence of its personnel.
12. An applicant should satisfy the Commission that it has proper business structures, good internal systems and qualified personnel to enable it to properly manage the risks it will encounter in carrying on its business as detailed in its business plan.

Continuous Assessment

13. A licensee must remain competent. The Commission must therefore be kept informed of material changes in a licensee's business and structure.
14. Change in business and structure may be regarded as material if the change has material impact on the nature and operation of the corporate licensee and may affect its ability to remain fit and proper. By way of example, the Commission will generally consider the following to be material:
 - (a) changes in key personnel;
 - (b) significant alteration to capital structure (whether debt or shareholder capital);
 - (c) changes in services or products provided;
 - (d) major modification to risk management policy; and
 - (e) key changes to internal control procedures.

15. Market participants are reminded that they are obliged by law to report to and seek approval from the Commission for any change in substantial shareholder.

Individual

Entry Assessment

16. Anyone applying to become individual licensees of a corporate applicant may show that they are competent by reason of their education, qualifications and experience. In appropriate cases, they are required to demonstrate necessary managerial competence.
17. To demonstrate competence, applicants should generally satisfy the Commission that they:
 - (a) have a good understanding of the regulatory framework including the laws and regulations and associated codes governing their intended industry sectors;
 - (b) are aware of the ethical standards² expected of a licensed person; and
 - (c) are knowledgeable of the financial products that they deal in or advise upon and the markets in which they provide services.

Continuous Assessment

18. Licensees should comply with the continuous professional training requirements as set out in the Guidance Note on Continuous Professional Training to demonstrate that they have taken steps to remain competent.

² One reference point is “Ethics in Practice – A Practical Guide for Financial Practitioners” published jointly with the Independent Commission Against Corruption, SAR in October 1999.

Test of Competence for Corporate Applicant

19. Examples of matters that will be considered by the Commission in assessing the competence of a corporate applicant are listed in Appendix 1.
20. Absence of the matters set out in Appendix 1 will not necessarily lead the Commission to conclude that the corporate applicant is not competent but it will call for some explanation. In particular, the Commission will want to be satisfied in the particular case, either that the matter is unnecessary for an intermediary of that size or one conducting that type of business or that the objective to be served by a particular arrangement, is addressed in some other way.
21. For businesses in which the scale of business operation and the staff numbers are relatively small, it is appreciated that sometimes in practice segregation of duties may not be possible. Under such circumstances, the Commission may consider alternative arrangements if the corporate applicant can demonstrate competence to manage risk exposures and to exercise effective control over operations. Clear written operational and compliance procedures should be available.

Test of Competence for Directors and Representatives

Directors

22. In assessing the competence of a director, the Commission will ensure that the director possesses appropriate ability, skills, knowledge and experience to properly manage and supervise the corporate applicant's proposed activities. An applicant applying to be a director will normally be expected to meet one of the following options.

(a) Option 1:

- possess an appropriate post secondary qualification in a financial discipline (such as degree in economics, finance, accounting, law) or equivalent, or obtain a pass in one of the recognised industry qualifications as set out in Appendix 2 not more than 3 years prior to the date of application;
- pass one of the recognised local regulatory framework papers as set out in Appendix 3 not more than 3 years prior to the date of application;
- have the equivalent of 3 years relevant industry experience over the 6 years immediately prior to the date of application; and
- have not less than 2 years proven management skill and experience.

(b) Option 2:

- obtain passes or above in English or Chinese, and Mathematics in HKCEE or equivalent;
- pass one of the recognised local regulatory framework paper as set out in Appendix 3 not more than 3 years prior to the date of application;
- have the equivalent of 5 years relevant industry experience over the 8 years immediately prior to the date of application; and
- have not less than 2 years proven management skill and experience.

Representatives

23. In assessing the competence of a person applying to be a representative (other than a director), the Commission will expect the applicant to have a basic understanding of the market in which they are to work as well as the laws and regulatory requirements applicable to the industry. This can normally be demonstrated by fulfilling one of the following options:

(a) Option 1

- obtain passes or above in English or Chinese, and Mathematics in HKCEE or equivalent;

- obtain a pass in one of the recognised industry qualification as set out in Appendix 2 not more than 3 years prior to the date of application; and
- pass one of the recognised local regulatory framework papers as set out in Appendix 3 not more than 3 years prior to the date of application.

(b) Option 2

- in a position of responsibility in the relevant industry³ for a period of not less than 2 years over the immediate past 5 years;
- obtain a pass in one of the recognised industry qualification as set out in Appendix 2 not more than 3 years prior to the date of application; and
- pass one of the recognised local regulatory framework paper as set out in Appendix 3 not more than 3 years prior to the date of application.

³ The specific types of responsibility in the relevant industry generally accepted by the Commission as compensating the lack of HKCEE or equivalent and relevant for licence as a representative are listed in Appendix 4 (B and D).

Points to Note

24. The recognised local regulatory framework paper and the industry qualifications mentioned above should be relevant to the activities to be performed by the applicant. For example, a securities dealer's representative applicant who relies on the HKSI Foundation Programme Examination should pass both the core paper and the securities elective paper. An applicant for licence as a securities dealer who is an Exchange participant in securities will be expected to pass both the paper on the Commission's regulation and the paper on rules of SEHK of the HKSI Financial Market Principal Programme Examination.
25. There is currently no recognised industry qualification for persons engaging in securities margin financing and leveraged foreign exchange trading. Depending on the level of responsibility and the type of licence sought, to demonstrate competence, applicants are generally expected to be able to display an understanding of the matters listed in paragraph 17. Completion of relevant industry courses or examinations will be favourably considered by the Commission.
26. Recognised industry qualifications are expected to be completed not more than 3 years prior to the date of application. However, the Commission will recognise qualification gained more than 3 years ago if the applicant has substantial relevant working experience and has remained in the industry (either in Hong Kong or overseas) or can prove recent registration with a relevant overseas regulator.

27. Some of the recognised industry examinations include a paper on the regulatory framework of Hong Kong. Applicants who complete such industry examinations will not be required to pass a separate local regulatory framework paper.
28. For director and representative applicants who satisfy the competence requirement, the Commission may license an individual who has yet to pass the local regulatory framework paper as a director or representative for that business on condition that the applicant must pass a recognised local regulatory framework paper within a reasonable time of obtaining a licence. This will afford the applicant the opportunity to assume duty in an appropriately supervised environment pending the passing of the course on the local regulatory framework. It should be noted that failure to obtain the pass within the specified time may render the licence invalid unless a further extension of time is granted by the Commission. The Commission may consider an extension of the time to pass the examination if it is satisfied that this will not pose an undue risk to the investing public. Where appropriate, the Commission may impose an additional condition on the licensee limiting the scope of business activities.
29. The Commission, in assessing the relevance of an applicant's experience, will consider the role and functions to be undertaken by the applicant. Experience gained in Hong Kong or elsewhere that is closely correlated to the functions to be performed will be recognised.

Role of the Academic and Accreditation Advisory Committee

30. The Commission's Academic and Accreditation Advisory Committee ("AAAC"), which comprises representatives from the Commission, the industry and academic institutions, will approve industry based qualifications and local regulatory framework papers for meeting the competence requirement.
31. The AAAC will from time to time amend the list of approved qualification that it has endorsed for meeting the competence requirement.

Summary of Options

32. A summary of the options for directors and representatives is attached in Appendix 5.

Date from which Effective

33. The requirements set out in this Guidance Note shall apply from 1 April 2001.

Examples of matters that will be considered by the Commission in assessing the competence of corporate applicants:

I. Organisational Structure:

(a) Corporate Governance

- the presence of an organisation structure with clear lines of authority
- a Board of Directors and senior management, including Committees of the Board, composed of individuals with an appropriate range of skills and experience to understand and run the corporation's proposed activities
- a Board of Directors and senior management, including Committees of the Board, organised in a way that enables it to address and control the activities of the corporation

(b) Business Profile and Risk Profile

- information on the proposed lines of business
- information on target market clientele, products and service type
- extent of system automation
- analysis of risks inherent to the key lines of business such as market risk, credit risk, liquidity risk and operational risk

(c) Risk Management and Control Strategy

- the presence of a clear risk management strategy with reference to the proposed lines of business
- the setting of proper exposure limits for each key line of business
- the anticipated risks being supported by the available capital (typically this will be demonstrated by a projected Financial Resources Rules calculation)
- the timing of review of established policies (e.g. subject to regular review or just with respect to changes in business and markets...etc)
- risk management and control strategy for branch operations

(d) Risk Management Policy and Procedures

- appointment of an independent risk manager⁴ who has the appropriate qualification to oversee and monitor the risk exposure and the systems of the corporation
- the presence of clear reporting lines for the independent risk manager
- the way that risks exposure limits are set and communicated to the trading staff
- the way that risks are monitored
- the way that risks are measured
- the procedures to deal with variation of risk limits
- processes to ensure that the corporation regularly carries out stress testing using appropriate measures, such as “value at risk”

⁴ The Commission will not insist that an independent risk manager or independent information technology manager be appointed if there is alternate arrangement in place which is sufficient to manage business risk exposures and exercise effective control over operations. This is irrespective of whether the alternate arrangement is undertaken in Hong Kong or elsewhere, at the local company level or group level. In any cases, there should be clear segregation of duties; the responsibilities of the risk manager should be clearly separated from that of front office personnel. Clearly, in most circumstances, more than 1 person will need to be appointed.

(e) Reporting and Control Functions

- the presence of reliable reporting systems ensuring that robust information is produced for risk management purpose
- the presence of control procedures to ensure data integrity and that data flowing into the risk management system should be consistent with trade and financial information

(f) Internal Audit and Compliance Functions

- internal audit and compliance personnel have appropriate qualifications and working experience to understand the corporate activities and risk profile
- internal audit group and compliance personnel are independent of core business functions and reporting directly to an independent and high level of authority
- internal audit group to perform periodic (at least annual) risk assessment and ascribe various levels of risk to an appropriate audit cycle
- all audit findings and compliance issues that are not resolved within established time frames must be reported to senior management

(g) Internal Control System

- adequate internal control systems set up in accordance with the relevant codes and guidelines
- arrangements in place to ensure proper audit trails are maintained
- the presence of procedures to deal with non-compliance
- requirements for the proper documentation of all operational and control procedures⁵

(h) Chinese Walls

- policies and procedures on “Chinese Wall” including “Cross Wall” to address conflicts of interests issues arising from carrying on more than one type of regulated activities concurrently (e.g. corporate finance and asset management activities) under a single licence.

(i) Information Technology Support

- appointment of an independent information technology manager⁴ who is appropriately experienced to maintain the integrity of the corporation's operating systems
- for corporations providing services over the internet, suitably qualified staff assigned to handle internet communication and transactions
- sufficient capital resources to meet necessary technological maintenance and improvements

⁵ Proper documentation of all operational and control procedures is essential for providing employees with the necessary guidance in running the business in accordance with the company's business objectives, professional standards and regulatory requirements.

II. Personnel :

(a) Qualified Staff

- the presence of policies and procedures to ensure that suitably qualified staff are in post including, but not limited to, all licensed employees, risk managers, compliance officers, heads of settlement desks and accounting officers
- all supervisory staff for both front and back office should have not less than 3 years relevant experience⁶ plus academic qualifications⁷

(b) Training Policies

(i) For new recruits

- arrangements to ensure that operational and control procedures are communicated to new employees
- arrangements to ensure relevant operational and control manual are distributed to staff and being accessible at any times

⁶ Relevant experience refers to practical experience gained in both front and back office, preferably at supervisory level.

⁷ Appropriate academic qualifications include degrees in related disciplines, relevant professional qualifications or completion of settlement or compliance related industry courses. Examples of “related” and “relevant” degrees or professional qualification include degrees or professional qualifications in law, accounting, business management, or risk management.

- (ii) For existing staff
- arrangements to ensure that changes to operational and control procedures are communicated to existing staff
 - the presence of appropriate staff on-going training policies and procedures

Recognised Industry Qualification for Directors and Representatives			
Country	Organising Body	Recognised Industry Qualification	
		Directors	Representatives
Hong Kong	Hong Kong Securities Institute	HKSI Diploma Programme Examination	HKSI Foundation Programme Examination
		Securities Brokers Examination	Broker's Representative Examination
		Licensing Examination for Securities and Futures Intermediaries ⁸ – Papers 7 to 12	Licensing Examination for Securities and Futures Intermediaries ⁸ – Papers 7 to 12
	The Stock Exchange of Hong Kong Limited	Securities Brokers Examination Securities Brokers Course	Broker's Representative Examination Broker's Representative Course
	The Financial Services Development Centre of the Vocational Training Council	Leveraged Foreign Exchange Trader's Responsible Director Examination – Paper 2	Leveraged Foreign Exchange Trader's Representative Examination – Paper 2
United States	The National Association of Securities Dealers, Inc.	General Securities Principal – Series 24	General Securities Representative – Series 7
		National Commodity Futures Examination – Series 3	
	The Association for Investment Management and Research	Chartered Financial Analyst (CFA) designation	Pass in Level 1 of CFA examination ⁹
Australia	The Securities Institute of Australia (SIA)	Diploma Courses provided by SIA	Certificates provided by SIA
United Kingdom	Financial Services Authority (FSA)	SFA Registered Persons Examinations	
Canada	Canadian Securities Institute (CSI)	Examinations conducted by CSI	
Japan	Japanese Securities Dealers Association	Representative of Public Securities Course	

- Note:**
- (1) Recognised industry qualifications for directors are also applicable to representatives.
 - (2) The above list of recognised industry qualifications will be updated from time to time by the Commission

Updated on 17 December 2002

⁸ Scheduled to be launched in April 2003 after the commencement of the Securities and Futures Ordinance

⁹ Not applicable to Leveraged Foreign Exchange Trader's Representatives

Recognised Local Regulatory Framework Paper		
Organising Body	Recognised Regulatory Framework Paper	
	Directors	Representatives
Hong Kong Securities Institute	HKSI Diploma Programme Examination – Paper 2 HKSI Financial Market Principal Programme Examination Licensing Examination for Securities and Futures Intermediaries ¹⁰ – Papers 1 to 6	HKSI Diploma Programme Examination – Paper 2 HKSI Financial Market Principal Programme Examination Licensing Examination for Securities and Futures Intermediaries ¹⁰ – Paper 1 HKSI Foundation Programme Examination – Paper 1
The Financial Services Development Centre of the Vocational Training Council	Leveraged Foreign Exchange Trader’s Responsible Director Examination – Paper 1	Leveraged Foreign Exchange Trader’s Responsible Director Examination – Paper 1 Leveraged Foreign Exchange Trader’s Representative Examination – Paper 1

Note:

The above list of recognised local regulatory framework paper will be updated from time to time by the Commission

Updated on 17 December 2002

¹⁰ Scheduled to be launched in April 2003 after the commencement of the Securities and Futures Ordinance

Types of Industry Experience relevant to Representative

- A. *Securities Margin Financier's Representative who is approved as a director under section 1211 of the Securities Ordinance*

Relevant industry experience would include margin financing, treasury and credit control at securities houses or financial institutions.

- B. *Leveraged Foreign Exchange Trader's Representative who does not handle discretionary account activities*

Experience in a related field such as treasury function in banking or corporation, or in a money broking industry would be recognised.

- C. *Leveraged foreign Exchange Trader's Representative who handles discretionary account activities and Leveraged Foreign Exchange Trader's Representative who is a responsible director under section 8(b)(ii) of the Leveraged Foreign Exchange Trading Ordinance*

Relevant industry experience would include direct foreign exchange trading experience in the inter-bank foreign exchange market or currency futures market, or its equivalent.

- D. *Representative other than Securities Margin Financier's Representative and Leveraged foreign Exchange Trader's Representative*

Experience in a related field such as banking, or accountancy, or in a broker's back office will be regarded as relevant.

Appendix 5

Test of Competence for Directors

	Option 1	Option 2
Educational qualification	Relevant degree Or Recognised industry qualification	Pass in Chin/ Eng + Maths in HKCEE
Local regulatory framework paper	Pass	Pass
Relevant industry experience	At least 3 yrs over past 6 yrs	At least 5 yrs over past 8 yrs
Management skill & experience	2 yrs	2 yrs

Test of Competence for Representatives

	Option 1	Option 2
Academic qualification	Pass in Chin/ Eng + Maths in HKCEE	---
Recognised industry qualification (specific to the functions to be performed)	Pass	Pass
Local regulatory framework paper	Pass	Pass
Relevant industry experience	---	At least 2 yrs over 5 yrs