

Manager-In-Charge initiative: Fostering accountability and a compliance culture

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Good morning, Jack¹, ladies and gentlemen.

It's my great pleasure to be here today to deliver a keynote speech at AIMA's annual conference. I would like to take this opportunity, at the beginning of the New Year, to talk about an important new initiative the SFC unveiled a month ago: the Manager-In-Charge initiative. This initiative aims to heighten the accountability of senior management, and it is applicable to all our licensed firms, including fund managers, broker-dealers and investment advisers. We set out the details in a circular published on 16 December and will implement them in the course of 2017.

I wish to devote the time here to discuss why we think it is important to foster a sense of genuine responsibility and clear accountability at the heart of a licensed corporation's activities, and how the Manager-In-Charge initiative can help drive proper conduct and behaviour. I will also discuss how firms should prepare for it.

2016 saw the continued development of Hong Kong as an international financial centre and asset management centre. Over the year, the total number of licensed corporations surged by 11% to more than 2,400. Even more spectacular was the 50% growth in new corporate applications. Roughly 60% of the newly-licensed corporations were licensed for Type 9 regulated activity, which is asset management. Meanwhile, the number of licensed representatives passed the 40,000 mark.

Since taking up the job of the executive director in charge of licensing and supervision of intermediaries last June, a question I have explored with my colleagues is how best we can drive proper behaviour and achieve better investor protection, given the limited regulatory resources at our disposal and a rapidly growing industry.

Disciplinary action is an effective backstop but it is not the whole solution. We hope to see more cases of misconduct detected by firms and reported to us, rather than having regulators detect them. We also hope to see front-line business managers take on the responsibility for compliance, instead of solely relying on the compliance department. Most of all, we hope to see a tone from the top that consistently and as a matter of course places client interests and the integrity of the market at the centre of business decisions. This, rather than mere reliance on disciplinary action to deter bad behaviour, is the key to ensuring proper behaviour and long-term business success.

¹ Mr Jack Inglis, CEO, AIMA.



I am aware of the diversity of financial services firms, which in Hong Kong range from a boutique hedge fund manager with fewer than 10 employees to a subsidiary of a global financial firm hiring over a thousand people. Regardless of whether the management style is Chinese, Western or Asian, at the heart of any corporation is a group of individuals at the top who run the firm and call the shots. If we want to improve conduct and change behaviour, it should start from the top by clarifying who has responsibility for what, and holding them accountable for the conduct and behaviour of the firm.

Now the concept of holding senior management of a corporation accountable for misconduct is nothing new. For example, in the Code of Conduct for Persons Licensed by or Registered with the SFC, it is explicitly set out in General Principle 9 that the senior management should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the firm. And in various places in our codes and guidelines², there are many references to the senior management being responsible for the adequacy and effectiveness of internal controls.

In the past, we did not spell out precisely who was regarded as senior management. But before approving a corporate licence application, we did require the corporation to appoint two Responsible Officers, or ROs, to be responsible and accountable for good governance and proper behaviour. The Responsible Officer regime, which came into effect in 2003, has worked generally well, but there are gaps when it comes to identifying who has real responsibility.

First, we have observed that some firms do not necessarily appoint their most senior managers as ROs. For example, in a recent review of the management structure of certain firms, we found a senior executive who is supervising six responsible officers but is himself only licensed as a representative. In some extreme cases, some junior executives are appointed ROs while the controlling minds of the firm stay in the shadows in the hope of escaping regulatory scrutiny.

Secondly, there was no systematic way for the SFC to collect management structure information, particularly for certain core functions such as risk management and compliance that do not constitute regulated activity.

That is why an important objective of the Manager-In-Charge initiative is to provide more guidance on who is regarded as senior management and who should seek to become ROs, as well as guidance on the management structure information which is required to be submitted to the SFC.

Specifically, we identified eight core functions, including overall management oversight, risk management and compliance, and the circular we issued last month required the corporation to appoint at least one individual to be in charge of each function. The circular set out clearly that in addition to directors and ROs of the firm, Managers-In-Charge of core functions would also be regarded as senior management.

A Manager-In-Charge can reside in Hong Kong or overseas, but he or she needs to be accountable to the corporation. In other words, we expect each Manager-In-Charge to report directly either to the board of directors or to the Manager-In-Charge with overall management

² For example, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the SFC, the Fund Manager Code of Conduct, the Corporate Finance Adviser Code of Conduct, the Code of Conduct for Persons Providing Credit Rating Services, and the Guideline on Anti-Money Laundering and Counter-Terrorist Financing.



oversight. To better align the senior management to the RO regime, we expressly state our expectation that RO status be sought by the Manager-In-Charge of overall management oversight as well as by those Managers-In-Charge of key business lines that involve regulated activities.

We also ask for a current organisational chart depicting the firm's management and governance structure, capturing all Managers-In-Charge appointed by the firm and their reporting lines, and require that this information be updated when there is a change. Collecting this information in a standardised format will ensure that the SFC is up-to-date about the senior management of a corporation.

Heightening awareness of current regulatory obligations

These new measures are built upon existing regulations. However, during our soft consultation exercise, we found that quite a few industry participants were not aware that they were subject to the SFC's existing disciplinary powers. Many of these were individuals who are not licensed but who manage functions such as information technology or risk management. They now know that even before the Manager-In-Charge initiative was introduced, they were already within the regulatory net for potential SFC disciplinary action.

Here, I feel obliged to reiterate that these new measures do not seek to increase the SFC's powers, nor to make Managers-In-Charge more liable to disciplinary action. Since the Securities and Futures Ordinance became effective in 2003, all regulated persons, including those involved in management, have been subject to disciplinary action³. Through this new initiative, we aim to heighten the awareness of Managers-In-Charge of their obligations and liability under the law, regardless of whether or not they are licensed.

One question often asked during the consultative exercise was, what are the disciplinary standards for "regulated persons"? Whether or not the SFC would discipline a regulated person depends on the specific facts of each case. In determining where responsibility lies, and the degree of responsibility which a particular member of senior management has, the SFC takes into account various factors including the individual's apparent or actual authority over the business and its operations⁴.

Preparing for implementation

We are cognisant of the fact that many licensed firms in Hong Kong are subsidiaries of global financial institutions and that matrix reporting is common. Decisions may be made at the group level by a global management committee sitting outside Hong Kong, and not by the local licensed firm. We are also aware that in some cases, the boundaries may get blurred between the responsibilities of senior executives at the group level and those of the regional or Hong Kong teams. Matrix reporting may also mean that some important decisions are made by senior executives who are several rungs above the CEO of the local firm and are not accountable to the local firm's board, or the board is not properly constituted to be held accountable for the conduct or behaviour of the corporation.

I've said earlier that it's important to establish a culture of accountability for conduct which starts with putting some clarity around the question of who has responsibility for what. We

³ Under Part IX of the Securities and Futures Ordinance.

⁴ Paragraph 1.3 of the Code of Conduct for Persons Licensed by or Registered with the SFC.



have no intention to require localisation of Managers-In-Charge, or to change anyone's reporting lines or governance structure.

But I was pleased to learn that some firms, in considering whom to appoint as Managers-In-Charge, are taking advantage of the opportunity to clarify their management responsibility and governance structure. In some cases, it may mean reviewing the composition of the local firm's board to take into account the responsibility to own up to the decisions made. In other cases, it may mean a change in reporting line to require some senior executives who reside overseas to report to the board. And in yet other cases, the local managerial team may have to step up to take overall corporate responsibility and be held accountable for the decisions they take.

We fully appreciate that for some global organisations, implementing this initiative may take time, particularly if it involves a change in governance structure. But we expect it to be bedded down over the course of this year. The board of each licensed firm is expected to allocate responsibility, to identify and appoint fit and proper individuals to act as Managers-In-Charge and to provide management structure information to us on or before 17 July. Those managers in charge of regulated activities are expected to have obtained or applied for RO status on or before 16 October.

On our part, we are ready to work closely with our licensed firms to guide them through the implementation phase. Today, we will issue another circular to all licensed firms, inviting them to send representatives to our workshops to be held in February and March. I would encourage you to enrol your responsible personnel to attend.

Closing remarks

Ladies and gentlemen, the concept of responsibility and accountability should not be too difficult to understand. Nobody seems to have any problems embracing this concept when it comes to allocating performance bonuses. Why should it be any different when it comes to allocating responsibility and owning up to the conduct behaviour of the corporation? Circling back to what I said at the start of this speech, we are aiming for a regulatory outcome whereby compliance is not the prerogative of one department, and that the front line managers nurture a culture of acting honestly, fairly and in the best interests of their clients and the integrity of the market⁵.

We urge all corporations to take ownership of the initiative and view this as a good opportunity for firms, especially those which might previously not have had this foremost in mind, to evaluate whether their current organisational structures and reporting lines are optimal, and whether they are properly documented and understood by everyone in the senior management. We are hopeful that the implementation of this new initiative will go a long way in driving better ex-ante decisions and proper behaviour, starting from the top management and then cascading down through the organisation.

Before closing, I wish to thank AIMA and other industry associations for their valuable comments during the consultation. We value our partnership with the industry and look forward to working even more closely with you to make this initiative work both for us regulators and for the industry.

⁵ General Principle 1 of the Code of Conduct for Persons Licensed by or Registered with the SFC.