

Press Release

LCQ2: Regulation of securities dealers

Wednesday, February 4, 2015

Following is a question by the Hon Tam Yiu-chung and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (February 4):

Question:

It is learnt that Goodcape Securities Limited (GSL) was a corporation licensed under the Securities and Futures Ordinance (the Ordinance) to carry on Type 1 regulated activity (dealing in securities). Following a complaint to the Securities and Futures Commission (SFC) about the failure of GSL to return client securities to the complainant, SFC issued a Restriction Notice on GSL on the 2nd of last month, prohibiting the firm from carrying on all regulated activities for which it was licensed under the Ordinance. On the other hand, while GSL operates as an introducing broker (commonly known as a "runner") that communicates client orders or introduces clients to other licensed securities dealers, some clients of GSL have indicated that they have no knowledge of this. In this connection, will the Government inform this Council:

(1) whether it knows the current number of runners in Hong Kong, since when and why SFC has allowed licensed securities dealers to operate as introducing brokers, and whether SFC has plans to publicise among investors the differences between the business of a runner and that of a general licensed securities dealer for protection of investors' interests;

(2) given that a licensed corporation is required under the Ordinance to notify SFC as soon as possible in the event that it is unable to maintain financial resources in accordance with the requirements, whether the Government knows the number of such notifications received by SFC from runners, as well as the respective numbers of cases in which SFC issued Restriction Notices to runners, revoked their licences and apply to the Court to freeze their assets, in each of the past 10 years, and the number of cases among them which involved fraud; and

(3) whether it knows the measures SFC has put in place to verify the authenticity of the content of the monthly financial resources returns submitted by runners, and if SFC will consider raising the liquid capital level that runners are required to maintain, or introducing new rules to ensure compliance by runners with the requirements on financial resources; if SFC will not consider, of the reasons for that?

Reply:

President,

(1) According to the information provided by the Securities and Futures Commission (the SFC), as of January 6, 2015, 58 licensed firms were subject to licensing conditions that limit their operation to introducing clients and/or communicating transaction orders in the names of the clients to other firms (i.e. operating as an introducing broker). Only seven of these firms introduce retail clients and/ or relay their orders in listed securities to other firms, while the remaining serve professional investors, transact in collective investment schemes or form part of a larger financial group.

Securities introducing broking has been a long standing business in Hong Kong and has been regulated by the various securities licensing regimes in place in Hong Kong for a number of decades. Under the former licensing regime in the now repealed Securities Ordinance and the licensing regime in the current Securities and Futures Ordinance (SFO), securities introducing broking has been recognised as a type of securities dealing activity and any person who carries on securities dealing activity is required to be registered or licensed.

Through the internet, seminars and mass media programmes, the Investor Education Centre (IEC) has been reminding investors that when they choose a securities broker, they should check the relevant information, including the individuals' and companies' licence status on the SFC website and find out from the register what types of regulated activities they are licensed for, as well as any conditions attached to the licence and disciplinary records, etc. The IEC will continue to reinforce these messages to investors.

(2) According to the information provided by the SFC, on February 8, 2006, a

securities introducing broker filed a notification on breach of the Financial Resources Rules (FRR) under section 146 of the SFO for liquid capital deficiency as of December 31, 2005. This was rectified on February 22, 2006. A caution letter was issued by the SFC on March 3, 2006.

Moreover, over the past ten years, the SFC had taken actions against two securities introducing brokers, including revoking the licence of Union Securities Limited (Union Securities) on July 24, 2014 and serving a restriction notice against Goodcape Securities Limited (GSL) and freezing its assets on January 2, 2015.

Concerning the revocation of licence of Union Securities, an SFC investigation found that Union Securities, with the involvement of two responsible officers, misappropriated about \$400,000 from two clients, and provided false and misleading information to the SFC. The two responsible officers fled Hong Kong in late 2012. As for the incident involving the GSL, enquiries and investigations remain active. To our understanding, the Police have classified the case as conspiracy to defraud, using false instruments, as well as carrying on business of taking deposits illegally, and are conducting a full criminal investigation.

(3) Currently, the SFC imposes stringent regulatory requirements on licensed corporations (including securities introducing brokers). Any person who applies for a licence to carry out any regulated activities (including securities trading) has to satisfy the fit and proper criteria as stipulated in the SFO. A licensed person is also required to comply with applicable regulatory requirements and licensing conditions at all times.

Licensed broker firms (including securities introducing brokers) are required to submit monthly financial returns to the SFC, which should be signed and certified by a responsible officer on behalf of the firm. As for the submission of annual audited accounts to the SFC by licensed firms, an independent auditor of the firm is required to express whether, in the auditor's opinion, the audited accounts give a true and fair view of the state of affairs of the firm, and to lodge a report with the SFC upon becoming aware of a reportable matter. If the SFC identifies any exceptions in the monthly financial returns and annual audited accounts submitted by a licensed firm or its independent auditor, the SFC will make further enquiry.

It is a criminal offence under section 384 of the SFO if a person provides information which is false or misleading in a material extent. A person who commits such an offence is potentially liable to a fine of \$1 million and to imprisonment for two years.

Regarding the capital requirements imposed by the SFC on a securities introducing broker, they are the same as those applied to a common stockbroker i.e. minimum paid-up share capital of \$5 million and minimum liquid capital of \$3 million, unless it has been approved as an "approved introducing agent" under the FRR. Under the FRR, "approved introducing agents" are subject to minimum liquid capital of \$500,000 and no minimum paid-up share capital requirement.

The SFC sets lower financial requirements for "approved introducing agents" because securities introducing brokers which have become "approved introducing agents" can only introduce clients and communicate buy and sell orders to an exchange participant in the names of the clients. According to the FRR, this type of broker firms must not incur any liability to any person in connection with their clients' transactions, and the SFC also imposes licensing conditions that forbid this type of broker firms from holding client assets or doing any business other than introducing clients.

In conclusion, the Administration and the SFC will keep the current regulatory regime under review to protect the interest of investors.

Ends