

# SFC SEEKS TO HALT "ROLLING BAD APPLES" IN THEIR TRACKS WITH LICENSING REFORMS

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Legal Briefings - By **William Hallatt, Hannah Cassidy, Natalie Curtis, Tess Lumsdaine, Emily Rumble and Isabelle Lamberton**

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On 1 February 2019, the Securities and Futures Commission (**SFC**) [announced](#) significant changes to its licensing forms and processes (Licensing Reforms). Included in these changes was the long-awaited arrival in Hong Kong of measures intended to stop the “rolling” of “bad apples” within the financial industry by requiring licensed corporations and registered institutions to provide the SFC with more information about the circumstances under which their employees depart.

In addition to these reforms targeting “bad apples”, the Licensing Reforms also include:

sweeping changes to the SFC’s licensing forms. These changes include streamlining and consolidating the forms, as well as reforms which will mean that applicants must now provide the SFC with significantly more granular information regarding matters relevant to fitness and properness; and

a thorough refresh of the SFC’s [Licensing Handbook](#), which now includes key aspects of the licensing-related guidance issued by the SFC since the publication of the previous *Licensing Handbook* in April 2017.

The new licensing forms can be used from 11 February 2019. However, the SFC will accept current standard forms during a two-month transition period, before the new forms become compulsory from 11 April 2019.

We have been following these developments for some time and were part of the informal consultation held by the SFC in late 2018. We will be holding a seminar in Hong Kong to share our insights on how these developments will impact licensed corporations in Hong Kong and form part of broader conduct and culture-focused reforms across the Asia-Pacific region.

#### **EVENING SEMINAR IN HONG KONG - 20 FEBRUARY 2019**

<b>Date:</b>	Wednesday 20 February 2019
<b>Time:</b>	6:00 - 7:00 pm Registration and drinks from 5:30 pm 7:00 - 8:30 pm - Cocktail reception
<b>Venue:</b>	The China Club, 14/F., The Old Bank of China Building, Bank Street, Central Please click <a href="#">here</a> to view map
<b>If you would like to attend, please email our <a href="#">Events Team</a>.</b>	

#### **REGULATORY FOCUS ON “ROLLING BAD APPLES” ARRIVES IN HONG KONG**

As discussed in our April 2018 [bulletin](#) on the Financial Stability Board (**FSB**)’s toolkit for misconduct risk, the FSB has encouraged regulators to do more to prevent individuals who engage in misconduct moving, or “rolling” between financial institutions without their misconduct being disclosed to their new employer.

The SFC has not explicitly identified its Licensing Reforms as part of an increased focus on “rolling bad apples”, despite the SFC’s Deputy CEO [stating](#) in October 2018 that the SFC has embarked on a “strategic effort to more closely track bad apples and...keep [them] out of the market”. However, it is clear that key elements of the Licensing Reforms are intended to achieve this objective.

In particular, under the new Form 5U, licensed corporations (**LCs**) and registered institutions (**RI**s) will need to:

- identify whether departing licensed representatives and responsible officers (**ROs**) were the subject of an internal investigation in the six months prior to their departure;
- provide details of this investigation if such details have not previously been provided to the SFC; and
- notify the SFC as soon as practicable if an internal investigation into that individual is commenced subsequent to making the initial notification of cessation.

This is a significant enhancement of the existing notification requirements, which require employers to identify a reason for cessation of employment, but only require details in relation to a cessation due to dismissal and where an employer identifies the reason for cessation as “other” than one of the options provided by the SFC.

This enhanced notification requirement is a clear signal from the SFC that individuals will no longer be allowed to escape regulatory scrutiny in relation to potential misconduct by simply resigning during the course of investigations and “rolling” to another firm. Instead, it seems highly likely that the SFC will take into consideration the information provided by employers regarding investigations of suspected misconduct in deciding whether that individual will be allowed to either transfer their accreditation as a licensed representative to another employer, or be approved as an RO of another firm. Further, we anticipate that the SFC may disclose information received from former employers to potential future employers of individuals suspected of misconduct, and that those potential employers will face questions regarding whether they are satisfied that those individuals are fit and proper to join their firm.

We anticipate that firms will face a number of key issues in complying with this enhanced notification requirement, including:

- potential litigation risk as a result of breaching their duty of care to former employees in relation to providing information about their employment;
- considering what constitutes an internal “investigation” of an individual (as opposed to, for example, an informal review); and
- the need to ensure that negotiated settlements which incorporate non-disclosure obligations allow for compliance with regulatory obligations, particularly given that information provided to the SFC must be true, accurate and complete.

### **FOCUS ON “FITNESS AND PROPERNESS”**

This enhanced notification requirement forms part of a broader focus by the SFC on fitness and properness. The new licensing forms introduced by the SFC as part of the Licensing Reforms include notable changes in relation to the information which must be provided by firms and individuals applying to become LCs, RIs, substantial shareholders or licensed representatives.

While applicants were already required to provide information regarding past disciplinary actions or investigations, their financial status (including, for example, whether they were the defendant or respondent to litigation) and character, the SFC has now indicated that it expects applicants to provide significantly more granular detail regarding each of these matters. In particular, the SFC has indicated that where an applicant states that it has been the subject of disciplinary actions in the last five years, or have ever been restricted from the right to carry on a particular business by a regulatory body, the SFC will expect applicants to provide, relevantly:

- the date of the relevant event;
- the regulatory body involved;
- a description of the disciplinary action;
- the applicant’s role or involvement in it; and
- its outcome or current status.

This is in contrast to current forms, which require only that applicants “provide information” regarding disciplinary actions.

These changes seek to shift the burden in relation to information regarding fitness and properness away from the SFC's case officers, who previously would have needed to consider the information provided by applicants and whether the SFC required additional details to be provided. In contrast, the refreshed forms clearly set out the SFC's expectations – and signal that the SFC expects applicants to fully inform the SFC of the details of matters relevant to their fitness and properness.

## **OTHER KEY REFORMS**

As noted above, the Licensing Reforms include a significant number of changes. However, key reforms include:

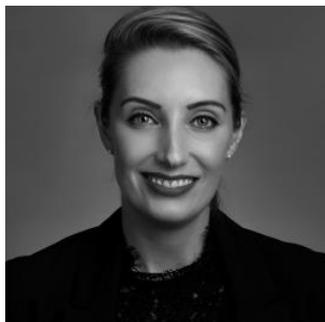
- **Simplification of substantial shareholder application process:** Substantial shareholders who are not “closely linked” with an LC or applicant for LC status may (subject to SFC discretion) provide less information when submitting a licence application.
- **Financial resource requirements for applicants:** Firms applying for LC status will now be required to demonstrate that they have sufficient financial resources to commence and maintain business operations. Applicants will need to submit a projection of operating expenses incurred in the first six months after having been licenced, and if projected expenses cannot be covered by excess liquid capital, then applications will also need to include a plan demonstrating the availability of additional funding if necessary.
- **RO requirements for exchange participants:** Due to the complexity of their businesses, the SFC has stated that it expects that exchange participants will have at least two ROs available locally at all times to directly supervise their brokerage businesses.
- **Additional guidance regarding licensing requirements for asset managers:** The SFC has observed that in many cases, firms which deal in, advise on or manage shares or debentures of private offshore companies falling outside the definition of “private company” under the Companies Ordinance will need to be licensed.

## **KEY CONTACTS**

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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