

SFC Guidance on Requirements for Licensing under the Law: **Reliable or Not**

Market participants seek guidance from the SFC with a view to ensuring compliance with applicable laws. Recently, the SFC has begun to take a more active role in providing such guidance, in many cases discouraging licensed persons from holding a license or indeed, indicating that the SFC will not grant a license based on its own interpretation of the law. As the courts alone can conclusively interpret laws, the SFC's approach is unsatisfactory, placing market participants at risk for breach of applicable laws. In this article, we discuss how market participants should proceed in the face of this dilemma.

The past months have seen increasing activism on the part of the Securities and Futures Commission (“SFC”) in providing guidance to the market on the interpretation of the Securities and Futures Ordinance (“SFO”). Whilst such guidance is often sought and welcomed by the market, recent guidance from the SFC has been disturbing in the vigor with which it has discouraged market participants from holding licenses under the SFO. A recent decision of the Hong Kong Court of Appeal serves as a reminder that the SFC does not have the jurisdiction to conclusively interpret the SFO. Where the SFC takes the position that a market participant does not need a license and refuses to grant a license based on this position, there is a real possibility that should the requirement for a license ever be litigated, a court may ultimately find that the market participant has breached the SFO.

Background

Since the enactment of the SFO in 2003, the SFC has issued responses to frequently asked questions (“FAQs”) and circulars to provide guidance on areas within its regulatory jurisdiction. Some of these FAQs and

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Whilst the decision of the Court of Appeal merely affirms long-standing law, it is a context specific reminder that market participants should not rely upon interpretations by the SFC to determine conclusively how to comply with the SFO.

circulars inform the market of the manner in which the SFC proposes to exercise its statutory jurisdiction under the SFO. However, some of these FAQs and circulars purport to provide definitive interpretations of the SFO.

Licensed Persons Conducting Activities Outside Hong Kong

For example, in April, 2010, the SFC issued a circular (“**Non-HK Activities Circular**”) which appears to provide definitive guidance on the licensing provisions of the SFO. The circular provides that:

“the SFO only permits the holder [of a license] to carry on business in a regulated activity... in Hong Kong. The SFO neither imposes upon corporations and individuals an obligation to be licensed in relation to activities which are conducted by them outside Hong Kong, nor confers upon them, after they have been licensed, the ability to conduct business outside Hong Kong... Accordingly, by way of example, individuals who are based in another jurisdiction for the purpose of performing the function of recruiting new clients from that other jurisdiction for a corporation that is licensed in Hong Kong, are not required to be licensed under the SFO.”

Licensing Requirements for Sale of ILAS

Similarly, for example, in August, 2009, the SFC issued a circular which sets out the SFC’s view on whether intermediaries who are insurance agents or insurance brokers (together “**insurance intermediaries**”) are required to be licensed by the SFC where they engage in promoting, offering or selling investment-linked assurance schemes (“**ILAS**”) to the Hong Kong public. Whilst this circular does not go so far as the Non-HK Activities Circular to provide a definitive interpretation

of the SFO, it does offer the SFC’s interpretation of the SFO and goes on to provide that the:

“SFC considers that insurance intermediaries need not be licensed under... the SFO... and the SFC does not regard insurance intermediaries as being in breach of... the SFO for the same reasons that insurers or corporate insurance brokers promoting, offering or selling ILAS to the public are not, namely, that they do not carry on a business in a regulated activity.”

The Ng Decision

These SFC circulars appear to be definitive in nature. However, in *Ng Chiu Mui and Anor v. the Securities and Futures Commission* (CACV 141 of 2009, May 26, 2010), the Court of Appeal affirmed that SFC interpretations of the SFO are not binding as a matter of law.

Facts

In this case, the appellants were licensed persons accredited to Hantec International Ltd. (“**Hantec HK**”), a company licensed with the SFC for Type 3 (leveraged foreign exchange) regulated activity. Hantec HK introduced trades to an affiliate (“**Hantec NZ**”) in New Zealand which was not licensed by the SFC or any other regulatory body. The SFC disciplined the appellants on the basis that they had aided and abetted Hantec NZ in carrying on a business in leveraged foreign exchange trading without a license. On appeal, the Securities and Futures Appeals Tribunal (“**Tribunal**”) (AN 7-9 of 2007, May 15, 2009) upheld the SFC’s disciplinary action.

Active Marketing

During the course of the proceedings, the Tribunal addressed the issue of whether Hantec NZ had actively

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marketed its services to the public in Hong Kong in breach of the SFO, ss. 114 and 115. In this regard, the Tribunal's attention was drawn to the SFC's FAQs on the SFC website which provide guidance on the ambit of the active marketing provisions of the SFO. The Tribunal dismissed the FAQs stating:

"I do not consider... the content of the SFC website to represent any more than straws in the interpretative wind."

Decision

On appeal, finding against the appellants, the Court of Appeal sided with the Tribunal, stating that:

"the SFC's view can be of no relevance as a matter of law unless it is a tool of statutory interpretation. Since [counsel] accepts that it is not such a tool, the Tribunal's approach was plainly correct."

Consequences of Decision

Whilst the decision of the Court of Appeal merely affirms long-standing law, it is a context specific reminder that interpretations by the SFC are mere opinions rather than conclusive and binding interpretations at law. Whilst such interpretations are always relevant because the SFC is the regulator responsible for enforcing the SFO and it is less likely that the SFC will enforce the SFO in a manner inconsistent with its own interpretations, the SFC does not have the exclusive authority to litigate a breach of the SFO.

A private litigant may, for example, allege a breach of SFO licensing requirements in proceedings against an intermediary. In this case, a finding by the court that the intermediary was in breach of the SFO

despite compliance with SFC guidance could require other intermediaries to shut down operations pending licensing.

Equally, for example, the SFC itself is free to change its interpretation and in this event, the SFC may take the view that a market participant which relied upon the SFC's interpretation was not entitled to do so as it did not fall within the circumstances then contemplated by the SFC.

Finally, it is not inconceivable that in an egregious circumstance, the Secretary for Justice, who is not in any way bound by SFC guidance, would seek to commence criminal proceedings against an intermediary for breach of licensing requirements under the SFO despite the intermediary's purported compliance with SFC guidance.

Conclusion

Market participants should remember that legal advice should be sought before relying upon guidance provided by the SFC. The guidance may be inapplicable to particular circumstances. Equally, the guidance may set out an interpretation of the law which may not be upheld by a court of law. In this latter regard, reliance on SFC guidance does not afford complete protection from the consequences for a breach of the law.

Consequences of Licensing Breaches

A breach of the licensing requirements under the SFO is a criminal offence, punishable on indictment by imprisonment for up to 7 years. A conservative approach to compliance clearly dictates that market participants should hold a license whenever there is any risk of breach without a license.

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Forward Action

New market participants should seek legal advice to determine whether there is any risk of a breach of the SFO if they perform certain functions without a license on the basis of an interpretation by the SFC of the SFO. If there is such a risk, they should apply for a license despite the SFC interpretation and may wish to consider extending the scope of the functions which they will actually perform to ensure that they perform functions which the SFC accepts require a license.

Where the SFC threatens to revoke the license of an existing market participant, the market participant should again consider extending the scope of the functions which it will actually perform to ensure that it performs functions which the SFC accepts requires a license. At the same time, it may consider whether to challenge the SFC's interpretation through the Securities and Futures Appeals Tribunal.