

# Setting Up In Hong Kong: A Guide for the Finance Industry

Hong Kong is increasingly seen as a necessary operations center for the financial industry. It is ranked by the Global Financial Centers Index as the world's most competitive financial centre after London and New York. It offers a well-regulated financial infrastructure and a transparent legal system and has in place comprehensive double taxation treaties with a number of Asian jurisdictions, including Mainland China.

In the banking sector, more than three-quarters of the world's top 100 banks have Hong Kong offices. In capital markets, Hong Kong is Asia's largest equity fund-raising centre as well as the largest source of foreign capital for Mainland China companies. Hong Kong is also Asia's leading fund management centre with the largest concentration of fund managers in Asia.

Financial industry participants who wish to establish an office in Hong Kong are generally subject to regulatory licensing, registration or authorization requirements. These requirements differ depending on the scope of activities to be undertaken. Different regulators and legislation regulate different sectors of the financial services industry.

## Securities and Futures

The Securities and Futures Ordinance ("SFO") governs the securities and futures markets, establishing regulations for intermediaries, offers of investment products and general conduct in these markets.

### Licensing and Registration

The SFO regulates 9 types of regulated activity. Generally, no person may carry on a business (or to hold itself out as carrying on a business)

### For more information

Timothy Loh,  
Principal  
[tloh@timothyloh.com](mailto:tloh@timothyloh.com)  
Hong Kong: +852 2899.0179

Guy Connell \*  
[gconnell@timothyloh.com](mailto:gconnell@timothyloh.com)  
Hong Kong: +852 2899.0140

Founded in 2004, TIMOTHY LOH, SOLICITORS has attained international recognition as a leading law firm. We have particular strengths in handling regulatory enforcement actions, complex tax, corporate and regulatory issues affecting the finance industry and mergers and acquisitions involving financial institutions. We are recommended by the International Financial Law Review 1000 as a leading law firm in banking and by the Legal 500 as a leading law firm in regulatory matters.

*\* Solicitor, England and Wales. Not admitted or registered as a lawyer in Hong Kong*

*The Securities and Futures Ordinance regulates 9 types of regulated activity. Generally, no person may carry on a business (or to hold itself out as carrying on a business) in a regulated activity unless, the person is a corporation licensed or registered by the Securities and Futures Commission for that regulated activity.*

in a regulated activity unless, the person is a corporation licensed or registered by the Securities and Futures Commission (“SFC”) for that regulated activity.

A person can be licensed or registered for more than one regulated activity. The more commonly encountered regulated activities are described below.

### **Type 1 (Dealing in Securities)**

“Dealing in securities” means making or offering to make an agreement with another person, or inducing or attempting to induce another person to enter into or to offer to enter into an agreement:

- for or with a view to acquiring, disposing of, subscribing for or underwriting securities; or
- the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities, by the person.

There are a number of applicable exemptions from Type 1 regulated activity, including the principal dealing exemption. Under this exemption, a person is not regarded as dealing in securities if he acquires, disposes of, subscribes for or underwrites securities as principal, or deals as principal with a person who is a professional investor.

Brokers and dealers in shares and other equities will generally carry out Type 1 regulated activity.

### **Type 2 (Dealing in Futures Contracts)**

“Dealing in futures contracts” means, whether as principal or agent and subject to prescribed exemptions:

- making or offering to make an agreement with another person to enter into, or to acquire or dispose of, a futures contract;

- inducing or attempting to induce another person to enter into, or to offer to enter into, a futures contract; or
- inducing or attempting to induce another person to acquire or dispose of a futures contract, by the person.

Under the SFO, a “futures contract” is defined as “a contract or an option on a contract made under the rules and conventions of a futures market”. Thus, “dealing in futures contracts” generally refers to dealing in an exchange-traded futures contract.

Brokers in commodities and futures will generally carry out Type 2 regulated activity.

### **Type 3 (Leveraged Foreign Exchange Trading)**

“Leveraged foreign exchange trading” means the act of entering into, offering to enter into or inducing or attempting to induce a person to enter into a contract the effect of which is that one party agrees or undertakes to:

- make an adjustment between himself and another person according to whether a currency is worth more or less, as the case may be, in relation to another currency;
- pay an amount of money or to deliver a quantity of any commodity determined or to be determined by reference to the change in value of a currency in relation to another currency; or
- deliver to another person at an agreed future time an agreed amount of currency at an agreed price.

“Leveraged foreign exchange trading” includes (i) the provision of financial accommodation to facilitate such an act, and (ii) entering into, offering to enter into or inducing or attempting to induce a person to enter into

*Managers of hedge funds, public funds, and REITs are generally regarded as carrying out Type 9 regulated activity. Private equity firms may be carrying out Type 9 regulated activity depending on their structure.*

an arrangement with another person, on a discretionary basis or otherwise, to enter into such an act.

The definition of “leveraged foreign exchange trading” is very broad and potentially includes all types of currency transactions. However, there are a number of exemptions, most notably currency exchange wholly referable to the provision of property or services.

Currency dealers who facilitate client trading on margin are generally carrying on Type 3 regulated activity.

#### **Types 4 and 5 (Advising on Securities and Futures Contracts)**

“Advising on securities” and “advising on futures contracts” mean, subject to prescribed exemptions:

- giving advice on whether, which, the time at which, or the terms or conditions on which, securities or futures contracts should be acquired or disposed of; or
- issuing analyses or reports, for the purposes of facilitating the recipients of the analyses or reports to make decisions on whether, which, the time at which, or the terms or conditions on which, securities or futures contracts should be acquired or disposed of.

The SFO exempts from Type 4 and 5 regulated activities advice given by a company its wholly owned subsidiaries, its holding company (provided the holding company owns the entire issued share capital of the company) and wholly owned subsidiaries of such a holding company.

Financial planners and investment research firms will generally be carrying out Type 4 or 5 regulated activity. Certain asset management groups, including private equity firms, and corporate finance advisers may also be carrying out Type 4 regulated activity.

#### **Type 6 License (Advising on Corporate Finance)**

“Advising on corporate finance” means, subject to prescribed exemptions, giving advice:

- concerning compliance with or in respect of the Listing Rules of the Stock Exchange of Hong Kong or the Codes on Takeovers and Mergers and Share Repurchases; or
- concerning (i) any offer to dispose of securities to the public, (ii) any offer to acquire securities from the public, or (iii) acceptance of any offer referred to in items (i) or (ii), but only in so far as the advice is given generally to holders of securities or a class of securities; or
- to a listed corporation or public company or a subsidiary of the corporation or company, or to its officers or shareholders, concerning corporate restructuring in respect of securities (including the issue, cancellation or variation of any rights attaching to any securities).

Corporate finance advisers of investment banks will generally be carrying out Type 6 regulated activity. Specialized sub-regimes apply to corporate finance advisers who carry out activities as sponsors to listings on the Stock Exchange of Hong Kong or as financial advisers in respect of takeovers of public companies.

#### **Type 9 License (Asset Management)**

“Asset management” is defined as real estate investment scheme management or securities and futures contract management. The latter means providing a service of managing a portfolio of securities or futures contracts for another person.

Managers of hedge funds, public funds, and REITs are generally regarded as carrying out Type 9 regulated activity. Private equity firms may be carrying out Type 9 regulated activity depending on their structure.

*Quite apart from licensing and registration requirements, any offer of any securities or regulated investment agreement to the public may, subject to prescribed exemptions, be subject to authorization requirements by the SFC.*

### Licensing under the SFO

Broadly, only corporations may apply for a license from the SFC. Thus, for example, a company incorporated in Hong Kong or overseas is eligible for a license but a partnership would not be eligible for a license.

### Fitness and Propriety

The SFC will refuse to grant a license to carry on a regulated activity unless the applicant can demonstrate that it is a fit and proper person to be licensed for the regulated activity based on its financial status and solvency, its educational or other qualifications or experience (or, in the case of a company, the educational or other qualifications or experience of its management), its ability to carry on the regulated activity competently, honestly and fairly and its reputation, character, reliability and financial integrity.

### Management

For the purpose of obtaining a SFC license, a corporation must appoint at least 2 responsible officers (“ROs”) approved by the SFC to directly supervise the conduct of each regulated activity. Generally, it is desirable to have at least 3 ROs as if there are only 2 ROs and one resigns, the statutory requirement for 2 ROs may be breached.

At least one of the ROs must be an executive director of the licensed corporation. At the same time, every executive director who actively participates in, or is responsible for directly supervising the corporation’s SFO regulated activity must be approved as an RO but otherwise, there is no requirement for ROs to be directors.

At least one of the ROs should always be available to supervise the regulated activity for which he has been approved as an RO. In practice, this means that at least one RO must be resident in Hong Kong.

The SFO states that the SFC shall refuse to approve an applicant as an RO unless he satisfies it that he is a fit and

proper person to be so approved (see above) and that he has sufficient authority within the licensed corporation. Generally, the SFC requires that an RO have:

- appropriate academic (*e.g.* MBA) or industry qualifications (*e.g.* lawyer, accountant or CFA);
- at least 2 years management experience;
- sufficient regulatory knowledge; and
- a minimum of 3 years or more of industry experience in the past 6 years in the regulated activity for which approval as an RO is sought.

### Regulatory Capital

Every licensed corporation must comply with minimum requirements as to paid-up share capital and liquid capital.

As a baseline, the minimum amount of paid-up share capital is HK\$5 million and the minimum amount of liquid capital is HK\$3 million or 5 per cent. of adjusted liabilities. However, certain regulated activities (*e.g.* leveraged foreign exchange trading and securities margin financing) carry higher paid-up share capital requirements.

Certain licensed corporations (*e.g.* asset managers) which do not hold client assets may qualify for no minimum paid-up capital requirements and minimum liquid capital requirements of HK\$100,000.

### Investment Offers

Quite apart from licensing and registration requirements, any offer of any securities or regulated investment agreement to the public may, subject to prescribed exemptions, be subject to authorization requirements by the SFC. Thus, for example, asset managers licensed by the SFC who wish to market investment funds to the public in Hong Kong may be required to seek authorization of the

*Under the Banking Ordinance, subject to prescribed exemptions, no banking business and no business of taking deposits may be carried out except by an institution authorized by the Hong Kong Monetary Authority.*

SFC both for the fund itself and the marketing materials for the fund.

## Banking and Deposit Taking

The Banking Ordinance (“BO”) establishes a tiered system for regulating banks in Hong Kong.

### Authorization

Under the BO, subject to prescribed exemptions, no banking business and no business of taking deposits may be carried out except by an institution (“**authorized institution**”) authorized by the Hong Kong Monetary Authority (“**HKMA**”). Broadly, there are 3 tiers of authorized institutions, namely:

- licensed banks;
- restricted license banks (“**RLBs**”); and
- deposit taking companies (“**DTCs**”).

Banks which intend to undertake regulated activities under the SFO in addition to their banking or deposit taking activities are required to register with the SFC in addition to being authorized under the BO by the HKMA.

### Banking Business

Banking business means (i) receiving from the general public money on current, deposit, savings or other similar account repayable on demand or within less than 3 months or at a call or notice of less than 3 months, or (ii) paying or collecting cheques drawn by or paid in by customers.

### Business of Taking Deposits

“Deposits” are defined as a loan of money (i) at interest, at no interest or at negative interest, or (ii) repayable at a

premium or repayable with any consideration in money or money’s worth. The term excludes loans:

- upon terms involving the issue, by any company, of debentures or other securities in respect of which a prospectus has been registered under the Companies Ordinance;
- upon terms referable to the provision of property or services; or
- by one company to another (neither company being an authorized institution) at a time when one is a subsidiary of the other or both are subsidiaries of another company).

A person will, in the absence of evidence to the contrary, be deemed to have been carrying on a business of taking deposits if that person does so on at least 5 separate occasions within any period of 30 days.

### Exemptions

The BO prescribes a number of exemptions from the authorization requirement. One exemption applies to corporations licensed under the SFO for Types 1 (dealing in securities), 2 (dealing in futures) or 3 (leveraged foreign exchange trading) regulated activities. Other exemptions apply to registered trust companies and credit unions and deposits taken from banks.

### Licensed Banks

Licensed banks are the only authorized institutions which may carry on banking business.

A bank incorporated overseas seeking authorization as a licensed bank must establish a branch in Hong Kong which will apply for authorization. Under the BO, a company incorporated in Hong Kong cannot become a licensed bank unless it has been an RLB or DTC for 3

*Licensed banks are the only authorization institutions which may carry on banking business... A bank incorporated overseas seeking authorization as a licensed bank must establish a branch in Hong Kong which will apply for authorization.*

continuous years or it is a subsidiary of a bank that has been authorized to carry on banking business in Hong Kong for at least 3 years. After 3 years, the bank may then seek to authorize a wholly-owned subsidiary of the bank in Hong Kong to assume the business of the branch.

Licensed banks must have an aggregate paid-up share capital (including share premium account) of not less than HK\$300 million (or an equivalent amount in any other approved currency). Furthermore, licensed banks must maintain total customer deposits of not less than HK\$3 billion (or an equivalent amount in any other approved currency) excluding deposits of other banks and certain affiliates and total assets of not less than HK\$4 billion (or an equivalent amount in any other approved currency).

#### **Restricted License Banks**

RLBs may carry on a business of taking deposits but are restricted to taking deposits of a minimum balance of HK\$500,000 from any one depositor. An RLB may take a deposit of a sum less than HK\$500,000 from a depositor if the amount standing to the credit of the depositor with the RLB, at the time any such deposit is taken, is not less than HK\$500,000. RLBs may not carry on banking business and thus, may not operate a chequing or savings account.

RLBs are principally engaged in merchant banking and capital markets activities.

Under HKMA practice, a bank incorporated overseas which seeks authorization as an RLB may either establish a subsidiary incorporated in Hong Kong as the RLB or a branch as the RLB.

An RLB must have an aggregate paid-up share capital (including its share premium account) of not less than HK\$100 million (or an equivalent amount in any other

approved currency). There are no minimum requirements as to customer deposits or total assets for an RLB.

#### **Deposit Taking Companies**

DTCs may carry on a business of taking deposits but are restricted to taking deposits of a minimum balance of HK\$100,000 from any depositor with an original term to maturity, or call or notice period, of at least three months. A DTC may take a deposit of a sum less than HK\$100,000 from a depositor if the amount standing to the credit of the depositor with the DTC, at the time any such deposit is taken, is not less than HK\$100,000. DTCs may not carry on banking business and thus, as with RLBs, may not operate a chequing or savings account.

DTCs are generally engaged in a range of specialized activities including consumer finance, trade finance, or securities business.

Under HKMA practice, a bank incorporated overseas which seeks authorization as a DTC must establish a subsidiary incorporated in Hong Kong as the DTC.

A DTC must have an aggregate amount of its paid-up share capital (including its share premium account) of not less than HK\$25 million (or an equivalent amount in any other approved currency). There are no minimum requirements as to customer deposits or total assets for a DTC.

#### **Controllers**

The HKMA must be satisfied as to the fitness and properness of the chief executive, directors and controllers of an authorized institution and, in the case of an institution incorporated outside of Hong Kong, the executive officer of the business in Hong Kong. At the same time, the HKMA must be satisfied that the institution has a system of control in place to ensure that

*A bank incorporated outside Hong Kong may apply to the HKMA for approval to establish a local representative office. Such an office may not carry out banking business or a business of taking deposits. Its business must be limited to representational and liaison activities.*

each person appointed as a manager of the institution is fit and proper.

### Regulatory Capital

Apart from paid-up capital requirements, authorized institutions may be subject to minimum requirements as to liquidity and capital adequacy.

- **Liquidity Ratio** - All authorized institutions must satisfy the prescribed liquidity ratio in respect of their operations in Hong Kong.
- **Capital Adequacy** - Authorized institutions incorporated in Hong Kong must, under the BO, maintain a capital adequacy ratio of 8 per cent. calculated on their operations worldwide. The HKMA in practice requires authorized institutions outside of Hong Kong to meet this requirement as well.

### Other Criteria for Authorization

The HKMA will not authorize an institution unless, amongst other things, it is satisfied that the business of the institution will be carried on with integrity, prudence and the appropriate degree of professional competence in a manner that is not detrimental and is not likely to be detrimental to the interests of depositors or potential depositors and, if the institution is incorporated outside of Hong Kong, that the institution is adequately supervised by the relevant banking supervisory authority in its place of incorporation.

### Local Representative Offices

A bank incorporated outside Hong Kong may apply to the HKMA for approval to establish a local representative office (“LRO”). An LRO may not carry out banking business or a business of taking deposits. Its business must be limited to representational and liaison activities. Typical functions

of an LRO include marketing of the services of the bank’s overseas offices to customers in Hong Kong and acting as a channel of communication between those customers and the bank’s overseas offices.

Under the BO, the HKMA may only approve an application for an LRO if it is satisfied that the bank is adequately supervised by the relevant overseas banking supervisory authority. In practice, the HKMA may wish to confirm that this overseas banking supervisory authority has no objection to the establishment by the bank of an LRO and confirm that the bank operates under a valid license to transact a full range of banking business in its country of incorporation.

An LRO is required to operate from a single business location.

### Lending

Under the Money Lenders Ordinance (“MLO”), subject to prescribed exemptions, no person shall carry on a business as a money lender without a money lender’s license. In this regard, a money lender is a person whose business (whether or not he carries on any other business) is that of making loans or who advertises or announces himself or holds himself out in any way as carrying on such a business.

Private equity firms which provide debt financing are not generally licensed as money lenders though it is prudent in each case where they provide such financing to ascertain whether the vehicle through which such financing is provided may be subject to licensing requirements.

Unlike the SFC and the HKMA, the Registrar of Money Lenders is not a regulatory body. It does not itself license money lenders (a magistrate in court does so) and it does not vet applications for licensing (the police does so). At

*[S]ubject to prescribed exemptions, no person shall carry on business as a money lender without a money lender's license. In this regard, a money lender is a person whose business... is that of making loans or who advertises or announces himself or holds himself out in any way as carrying on such business.*

the same time, it has no powers to establish requirements as to the conduct of business or to discipline licensed money lenders.

### **Failure to Obtain License**

Unlicensed money lenders are generally not entitled to recover in any court any money lent or any interest in respect thereof or to enforce any agreement made or security taken in respect of any loan made. However, a court has a discretion to permit such a recovery or enforce such an agreement or security if it considers that it would be inequitable to deny such recovery or enforcement.

### **Exemption for Authorized Institutions**

Authorized institutions are excluded from the scope of the MLO and are therefore not required to obtain a money lender's license to carry on money lending business. However, authorized institutions are subject to regulation by the HKMA pursuant to the BO in carrying on such lending activities and may, additionally, be subject to requirements of any banking association to which they belong (e.g. the Hong Kong Association of Banks).

### **Exemption for Licensed Corporations**

Corporations licensed under the SFO to carry on a business of dealing in securities and which engage in securities margin financing are exempt from the requirement to obtain a money lender's license.

### **Other Exemptions**

The MLO exempts a number of other types of loans, including loans which are secured by charges registrable under company law, loans made by a person whose ordinary business does not primarily or mainly involve lending of money and loans involving the issue of securities for which a prospectus has been registered under company law.