2 April 2019

Securities and Futures Commission
35/F Cheung Kong Center
2 Queen's Road Central
Hong Kong

Ms. Julia Leung
Executive Director, Intermediaries Division

Dear Ms. Leung,

Circular to announce new licensing forms and mandatory electronic submission of annual returns and notifications

We refer to the circular issued by the Securities and Futures Commission of Hong Kong (the "**Commission**") on 1 February 2019 to announce new licensing forms and mandatory electronic submission of annual returns and notifications (the "**Circular"**).

We note that, under Form 5U / the relevant section of the SFC Online Portal, from 11 April 2019 licensed corporations ("**LCs**") and registered institutions ("**RIs"**) will be required to:

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

The Asia Securities Industry & Financial Markets Association ("**ASIFMA**") and its members generally welcome this development in the context of the "rolling bad apples" phenomenon. As noted by the Financial Stability Board (**FSB**) in its toolkit for mitigating misconduct risk, this phenomenon is an important one and recurring misconduct by "bad apples" is '*especially vexing to both the industry* [and regulators] *because of a sense that something should have been done sooner*'[1].

[1] Financial Stability Board, '*Strengthening Governance Frameworks to Mitigate Misconduct Risk*: *A Toolkit for Firms and Supervisors*' p 33.

However, notwithstanding our general support for this measure, ASIFMA and its members are mindful that the Internal Investigation Disclosure Obligation could, if not applied thoughtfully, result in the Commission receiving an unwieldly volume of irrelevant disclosures, i.e. information which would not assist the Commission in achieving its objectives of reducing misconduct across the industry. This could in ASIFMA's view compromise the effectiveness of this measure. In particular, we are concerned that there is ambiguity in relation to the types of matters which should be disclosed under this Internal Investigation Disclosure Obligation. Specifically, it is unclear:

1. what types of internal processes would be considered "internal investigations" for the purposes of disclosure under the Internal Investigation Disclosure Obligation; and
2. what types of behaviour by a licensed representative or RO would be disclosable under the Internal Investigation Disclosure Obligation.

ASIFMA and its members are focused on ensuring that the Commission receives information that will assist it in achieving its objective of reducing misconduct across the industry. On this basis, ASIFMA and its members, with the assistance of Herbert Smith Freehills, have sought to establish some general parameters in relation to the process to be followed when considering whether a matter is required to be disclosed under the Internal Investigation Disclosure Obligation. In addition, whilst ASIFMA members welcome the Commission's focus on “rolling bad apples” there is a need to ensure that individuals are not unfairly prejudiced by the Internal Investigation Disclosure Obligation, by reports of matters that are not sufficiently serious to be of interest to the Commission. As such ASIFMA notes that there is a material litigation risk associated with such disclosures for our members.

On this basis ASIFMA considers that, in effect, members will need to undertake a two stage process when assessing whether a matter is disclosable under the Internal Investigation Disclosure Obligation, as follows:

1) **Stage 1: Consider whether, in the six months prior to the cessation of employment of a licensed representative or RO, that individual had been the subject of an internal process of the type which should be considered an "internal investigation"?**

In considering whether an internal process should be considered an "internal investigation", ASIFMA and its members have put together a non-exhaustive series of examples of the types of processes which should and should not be considered "internal investigations", as set out in the below table.

Types of internal processes which should be considered "internal investigations" for the purposes of the Internal Investigation Disclosure Obligation	Types of internal processes which should not be considered "internal investigations" for the purposes of the Internal Investigation Disclosure Obligation
1. Reviews by Compliance and/or other relevant departments (including Human Resources, Internal Audit or Operational Risk, or a dedicated Investigations function) of specific issues, events or incidents (such as client complaints) involving licensed individuals or ROs where an allegation or concern regarding suspected misconduct is put to an employee and they are provided with an opportunity to respond. 2. Review of specific issues, events or incidents involving licensed individuals or ROs by Compliance and/or other relevant departments where: • such reviews are tabled to a formal disciplinary committee for their consideration (where such a committee exists); or • the review has led to formal disciplinary action or consideration of whether formal disciplinary action is required in the circumstances.	1. Assessments (both internal and external) of anomalies in systems and controls or operational incidents: • identified by business or support units; or • made or raised by an external entity, body or individual (e.g. third party service providers). 2. Business-as-usual control processes, checks and escalations where there is no reasonable suspicion that misconduct has occurred, including, for example: • routine follow-ups on trade surveillance; or • communication surveillance alerts involving licensed individuals. 3. Initial assessment of a whistleblowing report where it is concluded under a LC / RI's internal whistleblowing policy that no further action is required (ie an investigation is not opened). 4. Reviews of poor performance by an employee (i.e. in the context of ongoing performance management).

2) **Stage 2:** If the individual has been the subject of an "internal investigation", then was that "internal investigation" in relation to alleged conduct of a type which should be disclosed under the Internal Investigation Disclosure Obligation?

ASIFMA and its members consider that, if it is identified that as a result of the Stage 1 process that a licensed representative or RO had been the subject of an internal investigation within the six months prior to their cessation of employment, a firm should then progress to considering whether the internal investigation was in relation to alleged conduct which warrants disclosure under the Internal Investigation Disclosure Obligation.

We have set out below a non-exhaustive description of types of behaviour which we consider should and should not be disclosed under the Internal Investigation Disclosure Obligation if the subject of an investigation meeting the requirements set out at Step 1.

Types of behaviour by a licensed representative or RO which should be disclosable under the Internal Investigation Disclosure Obligation	**Types of behaviour by a licensed representative or RO should not be disclosable under the Internal Investigation Disclosure Obligation**
Misconduct or alleged misconduct which: • triggers the reporting obligation under 12.5(a) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission **("SFC Code of Conduct")**; • raises fitness and properness concerns under the Commission's Fit and Proper Guidelines; • has an adverse market impact; • has an adverse client impact; or • involves fraud or corruption.	Minor breaches of internal policies where the misconduct: • is not sufficiently serious to warrant disciplinary action even if allegations are found to have been substantiated; and • involved only a breach of internal policies rather than regulatory obligations.

ASIFMA would welcome an opportunity to discuss this further with the Commission, or to receive any comments the Commission might have on the matters set out above. If the Commission has any comments or requires further clarification on any of the matters discussed in this letter, please do not hesitate to contact Patrick Pang (ppang@asifma.org).

Yours sincerely,

Mark Austen
Chief Executive Officer, ASIFMA

cc Patrick Pang, ASIFMA