

28 June 2021

Circular to licensed corporations

Operation of bank accounts

1. During the course of supervising licensed corporations (LCs), the Securities and Futures Commission (SFC) has noted some unsatisfactory practices in the operation of their bank accounts. These practices undermined LCs' ability to properly safeguard client money, promptly discharge their liabilities and fully comply with the financial resources requirements under the Securities and Futures (Financial Resources) Rules (FRR) at all times.
2. The SFC expects LCs to develop and implement effective policies, procedures and internal controls in relation to the operation of their bank accounts. The requirements set out in this circular cover the LC's house bank accounts¹ and client bank accounts², but not the LC's accounts at execution brokers or bank accounts established and maintained by the LC's clients in the clients' names.

Unsatisfactory practices

3. The SFC noted cases where LCs did not implement effective controls in relation to their bank account operations and authorised bank account signatory (authorised signer) arrangements³ to ensure that the LC's responsible officers (ROs) or Managers-in-Charge of Core Functions (MICs), who were involved in the day-to-day management of its regulated activities, have sufficient ability to direct, and sufficient oversight of, the deployment of the LC's cash resources⁴. In some cases, an LC's ROs, MICs and their delegates did not have proper access to information about the activities of its house and client bank accounts and adequate measures were not in place to monitor activities in these accounts. Below are some examples:

Inadequate or inappropriate controls

- (a) LCs' house or client bank accounts were operated *solely* by a shareholder, a director or a nominee of a shareholder or director, and these were not ROs, MICs or their delegates. The authorised signers were not subject to appropriate oversight in relation to the operation of the LC's bank accounts and were not accountable to any ROs or MICs.
 - (i) In a number of instances, LCs breached the financial resources requirements under the FRR after shareholders effected withdrawals

¹ For the purposes of this circular, an LC's house bank accounts include its payroll accounts, operating expenses accounts and any other bank accounts opened in the LC's name for holding money which it beneficially owns.

² For the purposes of this circular, this includes the client bank accounts established and maintained by the LC or its associated entities.

³ Including for electronic banking accounts.

⁴ In some cases, the LC had to ensure prompt settlement of payment obligations to a clearing house of which it was a member, including intra-day payments when required.

from the house bank account which the ROs, MICs and other staff had no control over.

- (ii) In a separate case, an LC's authorised signer (who did not have any official role at the LC) was an RO of another LC, and the two LCs were not in the same group.
 - (iii) In another case, the sole authorised signer for an LC's electronic banking account was a representative of the LC's holding company and was not an RO or MIC. The holding company was subject to a winding-up petition and this called into question the LC's ability to maintain sufficient financial resources and liquidity to continue its regulated activities without disruption.
- (b) Although controls for bank account operations were in place, such as requiring joint authorised signers to effect payments or different persons to be responsible for reviewing, authorising and effecting payments, deficiencies were still noted at some LCs. For example:
- (i) In one case, the only two authorised signers⁵ were not accountable to any ROs or MICs, and in another case two out of the three authorised signers were not⁶. Neither the ROs nor MICs were in a position to ensure that the LCs' settlement obligations to Hong Kong Exchanges and Clearing Limited were discharged in full in a timely manner. Some of these authorised signers were not physically operating at the LCs' office in the normal course of business.
 - (ii) Withdrawals from the house bank account of amounts below a specified threshold for transactions unrelated to regulated activities had to be approved by personnel who did not otherwise participate in the day-to-day management of the LC's operations. However, two of the three authorised signers⁷ were not accountable to any ROs or MICs, and hence these withdrawals could be effected without the approval or knowledge of any ROs, MICs or their delegates.
 - (iii) The only joint authorised signers who could operate the LC's bank accounts were a current shareholder who had resigned from the role of RO and an ex-shareholder.
 - (iv) Two of the three authorised signers⁸ were not ROs or MICs and were not accountable to any ROs or MICs, and therefore could effect payments from the LC's house and client bank accounts without the approval or knowledge of any ROs or MICs.

⁵ In this case, payment is required to be jointly effected by the only two authorised signers.

⁶ In this case, payment is required to be jointly effected by any two authorised signers.

⁷ In this case, payment is required to be jointly effected by any two authorised signers.

⁸ In this case, payment is required to be jointly effected by any two authorised signers.

Lack of timely and effective access to information for ROs and MICs

- (c) None of an LC's ROs, MICs or staff had access to information about the operation and activities of the house bank accounts except for the month-end bank statements. The MIC of Finance and Accounting had to rely on the LC's two directors, who did not otherwise participate in the day-to-day management of the LC's operations and were the only persons authorised to access the LC's bank accounts, for intra-month updates on transactions in the accounts. The MIC of Finance and Accounting could only verify transactions or identify unknown ones after receiving the monthly statements. Therefore, the MIC of Finance and Accounting, ROs and other MICs were not able to monitor the LC's liquid capital position or detect any suspicious account activity or improprieties in a timely manner.
- (d) The shareholder, who was not an RO or MIC, was the sole authorised signer for an LC's bank accounts. Monthly bank statements were delivered to the LC's office and usually kept by the shareholder. The ROs and MICs did not have direct access to information about the accounts or the ability to monitor them in a timely manner. They had to rely on the invoices and monthly bank statements provided by the shareholder to monitor the firm's liquid capital position, and hence were not aware of a breach of the financial resources requirements under the FRR after the shareholder had withdrawn funds from the LC's bank accounts.

Expected standards

Senior management responsibilities

- 4. Inadequate or inappropriate controls in relation to the operation of an LC's bank accounts, together with the lack of timely and effective access to information in relation to bank accounts for ROs and MICs, will undermine the LC's ability to:
 - (a) adequately safeguard client assets⁹;
 - (b) promptly discharge settlement or margin obligations to clearing houses and trading counterparties;
 - (c) ensure the availability of the financial resources needed for the proper performance of the LC's business activities¹⁰; and
 - (d) fully comply with the financial resources requirements under the FRR at all times.
- 5. Appropriate management on a daily basis of each area in paragraphs 4(a) to 4(d) is an integral part of the proper management of an LC's regulated activities. It is also

⁹ Paragraph 11.1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct).

¹⁰ General principle 3 of the Code of Conduct.

fundamental to the protection of client assets, the financial soundness of the LC as well as investor confidence in the firm and the wider market¹¹.

6. The ROs and MICs who are responsible for managing an LC's core functions and day-to-day operations play a critical role in the LC's compliance with its regulatory obligations in the performance of its regulated activities on a daily basis. This in turn has a direct bearing on the LC's ongoing fitness and properness to remain licensed with the SFC.
7. Accordingly, an LC's senior management should designate at least one RO or MIC¹² to be responsible for each area in paragraphs 4(a) to 4(d)¹³ (designated ROs or MICs), in addition to fulfilling its existing regulatory obligations to develop proper governance practices¹⁴ and implement effective internal controls¹⁵. The LC's board of directors should delegate sufficient authority to the designated ROs or MICs and empower them to:
 - (a) implement and operationalise policies, procedures and internal controls they consider necessary to prevent any act or omission which may adversely affect the LC's compliance with regulatory obligations for each area in paragraphs 4(a) to 4(d)¹⁶, including for the operation of bank accounts; and
 - (b) ensure that all authorised signers are subject to proper oversight and accountability with respect to the operation of the LC's bank accounts.
8. These controls should also take account of the regulatory requirements for the proper segregation of key duties and functions¹⁷.
9. All authorised signers should adhere to the governance framework established by the LC's senior management and comply with the policies, procedures and internal controls implemented by the designated ROs or MICs. The designated ROs or MICs should also have the authority to hold each authorised signer to account¹⁸ for any

¹¹ Under section VII(9) of the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (Internal Control Guidelines), appropriate and effective procedures are established and followed to protect the firm's and its clients' assets from theft, fraud and other acts of misappropriation. In particular, the authority of the firm and its staff to acquire, dispose of and otherwise move or utilise the firm's or its clients' assets is clearly defined and followed.

¹² The responsibility for each area in paragraphs 4(a) to 4(d) can be allocated to different ROs or MICs.

¹³ General principle 9 of the Code of Conduct. Although there are no restrictions on which ROs or MICs can be designated as responsible for each area in paragraphs 4(a) to 4(d), LCs are recommended to review Annex 1 of the [Circular to Licensed Corporations Regarding Measures for Augmenting the Accountability of Senior Management](#) issued on 16 December 2016 (MIC Circular) to determine the most appropriate persons. For example, given that the MIC of Finance and Accounting is expected to be responsible for ensuring the timely and accurate financial reporting and analyses of the firm's operational and financial positions, LCs may consider if it is appropriate to designate that MIC to be responsible for paragraph 4(d).

¹⁴ Section I of the Internal Control Guidelines.

¹⁵ Paragraph 4.3 of the Code of Conduct.

¹⁶ For example, the RO or MIC designated to be responsible for paragraph 4(c) to ensure the availability of the financial resources needed for the proper performance of the LC's business activities should have authority to access the LC's liquid capital budget and forecast, such that he possesses the necessary, pertinent information to make informed decisions about the LC's business activities. He should be empowered to direct or procure the orderly wind down of the LC's regulated activities if, after taking the relevant steps within his power (such as escalating the issue of insufficient liquid capital to the board of directors and shareholder) he considers that it is uncertain whether the LC's liquid capital will be sufficient for the continuation of the LC's regulated activities as a going concern.

¹⁷ Section II of the Internal Control Guidelines.

¹⁸ To be clear, the SFC does not require that all authorised signers be *only* accountable to the designated ROs or MICs.

operation of the LC's bank accounts which is not consistent with these policies, procedures and internal controls¹⁹.

Authorised signer arrangements

10. The SFC does not mandate any particular organisational or governance structure for LCs. However, in the ordinary course of business, an LC's shareholders (in such capacity) or their nominees are not expected to conduct day-to-day operations related to the LC's regulated activities, unless they are accountable to the ROs or MICs in respect of such daily operations. The SFC expects that the authorised signers²⁰ for effecting any form of payments out of an LC's house bank accounts should be:
 - (a) RO(s), MIC(s) or his / her delegate(s)²¹; or
 - (b) Any other person(s), provided that such person(s) can only effect payment jointly²² with RO(s), MIC(s) or his / her delegate(s).
11. Additionally, the SFC does not see a need to enable persons not involved in the day-to-day management of the LC's regulated activities to operate the LC's client bank accounts. To enhance the protection of client money, the SFC expects that the authorised signers for effecting any form of payments out of an LC's client bank accounts should only be RO(s), MIC(s) or his / her delegate(s)²³.
12. Whether a person is a delegate of an RO or MIC is a matter of fact, and depends on, for example, whether that person reports or is accountable to the RO or MIC and whether the RO or MIC has the actual authority to direct, and sufficient oversight of, that person's actions²⁴. For example, a delegate of an RO or MIC may be:
 - (a) Staff of the LC;
 - (b) Staff of the LC's group companies, where the LC is part of a global group with different functions in different jurisdictions, and the LC delegates the operation of its house bank accounts to effect payments on its behalf to (i) a centralised finance function at its parent company; or (ii) certain business or functional staff within its group affiliates; or

¹⁹ Under section V of the Internal Control Guidelines, senior management have the responsibility to maintain policies and procedures to ensure compliance with the firm's own internal policies and procedures.

²⁰ For the purposes of this circular, authorised signers include not only wet ink signers but also any person who is able, on behalf of the LC, to instruct or authorise the bank to make any payment from an LC's bank account via any means, including but not limited to online banking, any form of electronic payment, standing instruction or the set-up of direct debit arrangement. To reduce administrative burden, legacy authorised signer arrangements which are already in place before the date of this circular need not be revised solely by reason of paragraph 10 of the circular if they fall under either of the following categories: (a) direct debit arrangements with clearing houses; or (b) direct debit arrangements or standing instructions in relation to recurrent operating expenses which are necessary for the continuation of the LC's business and payable to an entity which is not in a controlling-entity relationship with the LC as defined under the Securities and Futures Ordinance.

²¹ Sub-delegation is permitted. It is up to the delegating RO or MIC to design the delegation arrangements.

²² An LC may choose to implement this joint signatory approach using group A / B signer arrangements, whereby group A may include any persons and group B only comprises ROs, MICs or their delegates.

²³ In addition to the requirements in this circular, LCs should consider the need to require two or more authorised signatures for house bank accounts and client bank accounts pursuant to paragraph 19 of the Suggested Control Techniques and Procedures of the Internal Control Guidelines.

²⁴ For example, depending on the actual facts of the specific case, a person whose instructions are expected to be acted upon by the RO or MIC in the normal course of the LC's business may not constitute a delegate of the RO or MIC.

- (c) A payment processing agent which processes payments necessary for the LC's ongoing operations in the normal course of business under an arm's length outsourcing arrangement.

13. Where delegates are authorised to operate an LC's bank accounts, the designated ROs or MICs should ensure that effective policies, procedures and internal controls are in place and they ultimately have sufficient oversight over the operation of the LC's bank accounts to effectively discharge their supervisory and regulatory responsibilities in relation to each area in paragraphs 4(a) to 4(d).

Timely and effective access to information in relation to bank accounts

14. The designated ROs or MICs responsible for each area in paragraphs 4(a) to 4(d) should also have timely and effective access (by himself / herself, or through his / her delegate) to all information about the operation and activities of the LC's house and client bank accounts, which is necessary for them to properly manage the risks associated with safeguarding client assets, ensuring the adequacy of financial resources²⁵ or fully complying with the financial resources requirements under the FRR at all times, according to their designated responsibilities.

Others

15. For access control purposes, where an LC has online banking accounts (whether house or client accounts), each user's access credentials (eg, passwords) should not be disclosed to another person, such that each user who has accessed the bank account and effected transactions can be uniquely identified, and unauthorised transactions can be detected.
16. As the Internal Control Guidelines state that an LC should establish, document and maintain an effective management and organisational structure²⁶, the SFC expects that an LC should adopt a formal document, approved by the board of directors, clearly setting out the firm's management structure, including the roles, responsibilities, accountability and reporting lines of its senior management personnel²⁷. In addition, it is expected that the document clearly sets out the allocation of the responsibilities with respect to paragraphs 4(a) to 4(d).
17. LCs should critically review their existing policies, procedures and internal controls to ensure proper implementation of, and full compliance with, this circular. To account for the time it may take for LCs to make necessary changes, we expect LCs to implement the expected standards by 3 January 2022.

²⁵ Paragraph 14.1 of the Code of Conduct.

²⁶ Section I of the Internal Control Guidelines.

²⁷ Please also refer to paragraph 28 of the MIC Circular.



18. Should you have any queries regarding this circular, please contact your case officers-in-charge.

Intermediaries Supervision Department
Intermediaries Division
Securities and Futures Commission

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