
SUMMARY OF LEGAL AND REGULATORY PROVISIONS

REGULATION

This section sets out summaries of certain aspects of the regulatory environment in Hong Kong, the U.S. and Singapore, which are relevant to the Group's business and operation.

REGULATORY ENVIRONMENT IN HONG KONG

Three-tier regulatory framework in Hong Kong

A three-tier regulatory framework exists in Hong Kong. The first tier of regulation, being the Hong Kong Government, has the ultimate responsibility for policy and legislative matters. The second tier and the third tier of regulation rested with the SFC and the HKEx, which are further described in the following paragraphs:

SFC

Established in May 1989, the SFC is the statutory body governed by the SFO which came into effect on 1 April 2003. The SFC serves as the principal regulator of the securities and futures market in Hong Kong. Furthermore, the SFC also has a role of monitoring listing applications and listed companies in Hong Kong. The SFC's regulatory objectives as set out in the SFO are:

- to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- to promote understanding by the public of the operation and functioning of the securities and futures industry;
- to provide protection for members of the public investing in or holding financial products;
- to minimise crime and misconduct in the securities and futures industry;
- to reduce systemic risks in the securities and futures industry; and
- to assist the Financial Secretary of the Hong Kong Government in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the securities and futures industries.

It is the task of the SFC to license any person carrying on a business of dealing in securities or futures like securities dealers, futures dealers, etc. Furthermore, it supervises and monitors the operations of the HKEx, which operates the Stock Exchange, the Futures Exchange and HKSCC. It also regulates listed companies by approving changes to the Listing Rules, monitoring announcements and vetting listing application materials under the dual filing regime, administering the Takeovers Code and considering requests for exemptions from prospectus requirements under the Companies Ordinance. The SFC can also enquire into listed companies suspected prejudicial or fraudulent transactions or provision of false or misleading information to the public. All members of the board of the SFC are appointed by the Chief Executive of Hong Kong.

SUMMARY OF LEGAL AND REGULATORY PROVISIONS

The SFC is divided into four operational divisions in order to carry out its tasks:

- The Corporate Finance Division is responsible for the dual filing functions in relation to listing matters, administering the Takeovers Code, overseeing the Stock Exchange's listing-related functions and responsibilities, and administering securities and company legislation relating to listed and unlisted companies.
- The Intermediaries and Investment Products Division is responsible for devising and administering licensing requirements for securities and futures, and leveraged foreign exchange trading intermediaries, supervising and monitoring intermediaries' conduct and financial resources, and regulating the public marketing of investment products.
- The Enforcement Division is responsible for conducting market surveillance to identify market misconduct for further investigation, undertaking inquiry into alleged breaches of relevant ordinances and codes, including insider dealing and market manipulation, and instituting disciplinary procedures for misconduct by licensed intermediaries.
- The Supervision of Markets Division is responsible for supervising and monitoring activities of the exchanges and clearing houses, encouraging development of the securities and futures markets, promoting and developing self-regulation by market bodies.

HKEx

HKEx forms the third tier of the regulatory framework. HKEx is a recognised exchange controller under the SFO. It owns and operates the only stock and futures exchanges in Hong Kong, namely the Stock Exchange and the Futures Exchange, and their related clearing houses. The Stock Exchange has the following responsibilities:

- (a) to establish a stock exchange and to provide, regulate, and maintain facilities for conducting the business thereof;
- (b) to provide and operate a stock market and to promote and protect the interests of all members of the public having dealings on the Stock Exchange or with members thereof;
- (c) to provide and promote a fair, orderly, and efficient market for the trading of securities;
- (d) to establish and promulgate rules prescribing listing requirements for the quotation of securities on, and in respect of such other matters as are necessary or desirable for the proper and efficient operation and management of, the stock market;
- (e) to administer the Listing Rules fairly, in accordance with the general principles set out in the respective rules, and having regard to the best interest of each market and Hong Kong's stock market as a whole and the public interest;
- (f) to ensure that persons administering the Listing Rules are independent, professional, and competent; and

SUMMARY OF LEGAL AND REGULATORY PROVISIONS

- (g) to establish fair and appropriate procedural rules governing the manner in which it will discharge its listing-related functions and responsibilities.

The Futures Exchange has the role to operate and maintain a futures market and is the primary regulator for Futures Exchange Participants with respect to trading matters.

The role of the clearing houses of HKEx is to provide services for the clearing and settlement of securities, stock options and futures transactions on the Stock Exchange and the Futures Exchange.

Licensing regime

The SFC operates a system of authorising corporations and individuals (through licenses) to act as financial intermediaries. The SFC issues licenses to corporations and individuals carrying on the following regulated activities:

- Type 1 — dealing in securities;
- Type 2 — dealing in futures contracts;
- Type 3 — leveraged foreign exchange trading;
- Type 4 — advising on securities;
- Type 5 — advising on futures contracts;
- Type 6 — advising on corporate finance;
- Type 7 — providing automated trading services;
- Type 8 — securities margin financing; and
- Type 9 — asset management.

Persons applying for licenses and registrations under the SFO, including Licensed Representatives and Responsible Officers, must satisfy and continue to satisfy after the grant of such licenses that they are fit and proper persons to be so licensed or registered. In simple terms, a fit and proper person means one who is financially sound, competent, honest, reputable and reliable. The Fit and Proper Guidelines are issued by the SFC, which outline a number of matters that the SFC shall have regarded to in assessing a person's fitness and properness, which include his:

- (a) financial status or solvency;
- (b) educational or other qualifications or experience having regard to the nature of the functions to be performed;
- (c) ability to carry on the regulated activity competently, honestly and fairly; and
- (d) reputation, character, reliability and financial integrity.

The above matters must be considered in respect of the person (if an individual), the corporation and any of its officers (if a corporation) or the institution, its directors, chief executive, managers and executive officers (if an authorised financial institution).

SUMMARY OF LEGAL AND REGULATORY PROVISIONS

In addition, section 129(2) of the SFO empowers the SFC to take into consideration any of the following matters in considering whether a person is fit and proper:

- (a) decisions made by such relevant authorities as stated in section 129(2)(a) or any other authority or regulatory organisation, whether in Hong Kong or elsewhere, in respect of that person;
- (b) in the case of a corporation, any information relating to:
 - (i) any other corporation within the group of companies; or
 - (ii) any substantial shareholder or officer of the corporation or of any of its group companies;
- (c) in the case of a corporation licensed under section 116 or 117 of the SFO or registered under section 119 of the SFO or an application for such licence or registration:
 - (i) any information relating to any other person who will be acting for or on its behalf in relation to the regulated activity; and
 - (ii) whether the person has established effective internal control procedures and risk management systems to ensure its compliance with all applicable regulatory requirements under any of the relevant provisions;
- (d) in the case of a corporation licensed under section 116 or 117 of the SFO or an application for the licence, any information relating to any person who is or to be employed by, or associated with, the person for the purposes of the regulated activity; and
- (e) the state of affairs of any other business which the person carries on or proposes to carry on.

The SFC is obliged to refuse an application to be licensed if the applicant fails to satisfy the SFC that he is a fit and proper person to be licensed. The onus is on the applicant to make out a case that he is fit and proper to be licensed for the regulated activity.

Applications as Licensed Representatives must demonstrate the competence requirement under the SFO. An applicant has to establish that he/she has the requisite basic understanding of the market in which he/she is to work as well as the laws and regulatory requirements applicable to the industry. In assessing an applicant's competence to be licensed as a Licensed Representative, the SFC will have regard to the applicants' academic qualification, industry qualification and regulatory knowledge.

Applications as Responsible Officers must demonstrate the requirements on both competence and sufficient authority. An applicant should possess appropriate ability, skills, knowledge and experience to properly manage and supervise the corporation's business of regulated activities. Basically, the applicant has to fulfill certain requirements on academic/industry qualification, industry experience, management experience and regulatory knowledge.

SUMMARY OF LEGAL AND REGULATORY PROVISIONS

If an applicant intends to conduct regulated activities in relation to matters falling within the ambit of a particular code issued by the SFC, e.g. the Takeovers Code or the Code on Real Estate Investment Trusts, additional competence requirements specific to that field would apply.

Pursuant to the FRR, a licensed corporation shall maintain a minimum liquid capital at all time of the higher of the amount of (a) and (b) below:

- (a) the amount of:
 - (i) HK\$100,000, where the licensed corporation is licensed for Type 4, Type 5 and Type 9 regulated activities in the case where the licensed corporation is subject to the licensing condition that it shall not hold client assets;
 - (ii) HK\$500,000, where the licensed corporation is licensed for Type 1 regulated activity in the case where the licensed corporation is an approved introducing agent or trader; or
 - (iii) HK\$3,000,000, where the licensed corporation is licensed in any other case for Type 1, Type 4, Type 5 and Type 9 regulated activities.
- (b) 5% of the aggregate of:
 - (i) the licensed corporation's on-balance sheet liabilities including provisions made for liabilities already incurred or for contingent liabilities but excluding certain amounts stipulated in the definition of "adjusted liabilities" under the SFO;
 - (ii) the aggregate of the initial margin requirements in respect of outstanding futures contracts and outstanding options contracts held by the licensed corporation on behalf of its clients; and
 - (iii) the aggregate of the amounts of margin required to be deposited in respect of outstanding futures contracts and outstanding options contracts held by the licensed corporation on behalf of its clients, to the extent that such contracts are not subject to payment of initial margin requirements.

If a licensed corporation offers credit facilities its clients who would like to purchase securities on a margin basis, or provides financing for applications of shares in connection with IPOs, it must monitor its liquid capital level continuously in order to satisfy the above requirement under FRR. If the margin requirement of the licensed corporation increases, it is required to maintain additional liquid capital, which can be achieved by a direct injection of share capital, or by using a subordinated loan on a temporary basis and in a form agreed by the SFC to be treated as part of the capital base (with features such as last right of repayment).

Anti-money laundering and terrorist financing

Licensed corporation registered under the SFO is required to comply with applicable anti-money laundering laws and regulations in Hong Kong, for example, the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap.405), the Organized and Serious Crime Ordinance

SUMMARY OF LEGAL AND REGULATORY PROVISIONS

(Cap.455), the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575) and the Prevention of Money Laundering and Terrorist Financing Guidance Note issued by the SFC. These laws and regulations require the Group, among other things, to adopt and enforce “know your clients” policies and procedures and to report suspicious and large transactions to the applicable regulatory authorities.

The Group has established a number of policies and procedures for the prevention of money laundering and terrorist financing. Before opening client accounts, the customer service staff is required to check against the anti-money laundering list and the list of Politically-Exposed Persons before accepting a new client. A “Risk Screen Report” is generated showing the results of the PEPs and the exposure of the client against a database provided by an external service provider and there is documented evidence of checking by the customer service team of client’s identity against the anti-money laundering list. Customer due diligence for individual and corporate clients are also conducted to enable the Group to establish the true and full identity of each client. Ongoing monitoring for funds deposited into clients’ accounts are conducted by requiring clients to provide evidence to show that monies have been deposited into their accounts; failing which, the Group will temporarily treat the deposits as unidentified deposits and record the same in “Abnormal Deposit Report” until evidence can be provided to the Group to show that the monies were deposited by the clients.

REGULATORY FRAMEWORKS IN US AND SINGAPORE

Regulatory framework in US

The regulatory framework for the U.S. futures exchanges can be traced back to 1922 when the Grain Futures Act was enacted which is based on the interstate commerce clause and bans off-contract-market futures trading rather than taxing it. The Grain Futures Administration is formed as an agency of the U.S. Department of Agriculture to administer the Grain Futures Act. The Grain Futures Act also creates the Grain Futures Commission, which consists of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General. The authority to suspend or revoke a contract market designation is vested in the Grain Futures Commission. The Commodity Exchange Act was subsequently imposed in 1936 to replace the Grain Futures Act. The Grain Futures Commission became the Commodity Exchange Commission and continues to consist of the Secretary of Agriculture, the Secretary of Commerce, and the Attorney General. The Commodity Exchange Act granted the Commodity Exchange Commission the authority to establish Federal speculative position limits, but not the authority to require exchanges to set their own speculative position limits. The Commodity Exchange Act, among other things, also required futures commission merchants to segregate client funds that were deposited for purposes of margin, prohibited fictitious and fraudulent transactions such as wash sales and accommodation trades, and banned all commodity option trading. The option ban remained in effect until 1981.

The Commodity Exchange Act was amended in 1968 to institute minimum net financial requirements for futures commission merchants. The amendment also enhanced the enforcement provisions of the act in various ways, including enhanced reporting requirements, increases in criminal penalties for manipulation and other violations of the act, and a provision allowing for the suspension of

SUMMARY OF LEGAL AND REGULATORY PROVISIONS

contract market designation of any board of trade that fails to enforce its own rules. CFTC's mandate has been renewed and expanded several times, most recently by the Commodity Futures Modernisation Act of 2000.

Regulatory framework in Singapore

No statutory regulation of the stock exchange of Singapore (now SGX) until in 1973 when Securities Industry Act was enacted. In 1986, the government revised the Securities Industry Act and enacted the Futures Trading Act. From that point, there was a general tightening up of securities regulation up to the Asian financial crisis in 1997. Since then, there have been changes to the regulatory balance of the market, culminating in the enactment in 2001 of the Securities and Futures Act ("SFA"), which came into force in various stages in 2002.

Under the present regulatory scheme, the Monetary Authority of Singapore regulates the overall financial sector, including the securities and futures industries, although the day to day supervision of the market is left with SGX. The internal management of SGX is regulated by its memorandum and articles of association, while trading in securities is regulated by the SGX Rules.

In addition to the Securities and Futures Act, listed companies in Singapore are also subject to the Companies Act, which makes provision for matters such as the formation of audit committees for publicly listed companies. The securities industry is also regulated by subsidiary legislations, the Companies Regulations and Securities and Futures Regulations, which are promulgated under the Companies Acts and the SFA respectively. In practice, other non-statutory rules also apply, such as the Singapore Code on Take-overs and Mergers, as well as the Code on Collective Investment Schemes.