



PAST QUESTIONS AND ANSWERS (December 2006)

PAPER 2

REGULATION OF SECURITIES

of

The Licensing Examination
for Securities and Futures Intermediaries

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Methodology of Developing Questions

Our Institute is committed to providing questions of the highest quality.

Our current examination structure has been benchmarked against those in both developed and emerging markets such as UK, US, Australia, Singapore, Malaysia and China. The syllabuses, study materials, training guides and questions were designed by international consultants specializing in financial education.

The Licensing Examination has been approved by the Academic and Accreditation Advisory Committee of the Securities and Futures Commission (SFC) as recognized industry qualification and local regulatory framework paper for meeting the competence requirements of the SFC.

External consultants are appointed to develop new questions according to specified criteria approved by our Examinations Committee. The aim of these criteria is to ensure that the candidates have thorough understanding of the manuals by testing them at different cognitive levels such as recall, comprehension, application, analysis and evaluation on predetermined weightings of each topic. The new questions are reviewed by reviewers who are market practitioners, legal and compliance professionals, and academics to ensure that the knowledge tested is covered in the study manuals, and that the standard of the questions is appropriate and consistent throughout.

To maintain their quality, the questions undergo frequent reviews and revisions internally which take into account, among others, the average correctness of the questions (i.e., the percentage of candidates in the examination who correctly answer the questions) and candidates' comments, if any, following each examination. In addition to the quality assurance being imposed on the questions, external assessors who are market practitioners, legal and compliance professionals, and academics, are engaged to conduct regular reviews. There are also periodic comprehensive reviews by external consultants on the manuals and questions.

The study manuals and their subsequent updates are the only source of materials for the setting of the questions, so that candidates need to study only those manuals and updates to prepare for the examinations.

It is estimated that the study manuals will require 6 to 11 hours of study time per topic, depending on which paper it is. Candidates may need to spend more or less time, depending on their work experience and background. They are advised to use the Learning Outcomes for each topic as a key to the way they study the materials in each topic, and unless explicitly stated, they could be tested on any aspect of the syllabus.

**Please attempt ALL 40 questions in this question book.
All questions carry EQUAL MARKS.**

<1>.

A client sells shares in X listed company. On the same day it is suspended from trading. Which of the following statements are **CORRECT**?

- I The selling intermediary must take delivery of the stock from his client and settle with the client as normal.
 - II The intermediary must reverse his deal with the client under the Securities and Futures (Suspension of Trading) Rules.
 - III The buying intermediary must take delivery of the stock and deliver to his client as normal.
 - IV If either of the intermediaries or clients lose out as a result of the suspension, they are entitled to claim compensation from the Compensation Fund.
-
- A I and III only
 - B I and IV only
 - C II and IV only
 - D I, III and IV only

<2>.

Which of the following statements concerning the laws which may affect the operation of an intermediary in Hong Kong are **CORRECT**?

- I The parties to a contract must have legal capacity.
 - II Under common law, an employee should demonstrate skills, competence and confidentiality.
 - III Under the Personal Data (Privacy) Ordinance, an intermediary, if so requested, must provide a client with all the personal data held free of charge.
 - IV An intermediary is liable if his account executive cheats a client.
-
- A I and III only
 - B III and IV only
 - C I, II and IV only
 - D I, II, III and IV

<3>.

Corporation XYZ is applying to the Securities and Futures Commission (SFC) for licensing for Type 1 (dealing in securities) regulated activity. In reviewing the SFC's Fit and Proper Guidelines, XYZ's Chairman notes some potential problems with his directors. Which **ONE** of the following directors is **LEAST** likely to adversely affect the SFC's assessment of the fitness and properness of XYZ to be licensed?

- A Mr. Chan was discharged from bankruptcy in Canada 10 years ago.
- B Mrs. Wong was discharged from bankruptcy in Hong Kong 3 years ago.
- C Mr. Smith is currently facing a criminal charge in Hong Kong killing a pedestrian when driving.
- D Mrs. Jones was a substantial shareholder in a company in Singapore which was found to be insolvent 3 years ago.

<4>.

Which of the following matters are covered in the Companies Ordinance?

- I Duties and liabilities of directors.
 - II Listing of companies.
 - III Issue of contract notes.
 - IV Issue of prospectuses.
- A I and IV only
 - B II and III only
 - C III and IV only
 - D I, III and IV only

<5>.

Which of the following investors are eligible to have the full amount of their claim paid from the investor compensation fund in the case of a default?

- I A retail investor who has dealt through a licensed intermediary, which is not a participant of the Stock Exchange of Hong Kong (SEHK), in a security which is traded on the SEHK, and who has lost HKD120,000.
 - II A retail investor who has dealt through an options exchange participant of the SEHK, and who has lost HKD150,000.
 - III An institutional investor who has dealt through a participant of the SEHK, and who has lost HKD100,000.
 - IV A retail investor who has dealt through a single exchange participant in both the SEHK and the Hong Kong Futures Exchange (HKFE) for different products, and who has lost HKD100,000 in securities and HKD100,000 in futures contracts.
- A II and IV only
 - B III and IV only
 - C I, II and III only
 - D I, II and IV only

<6>.

Under the Securities and Futures (Financial Resources) Rules, which **ONE** of the following reporting requirements for a licensed corporation is **CORRECT**?

- A The annual audited accounts must be submitted to the Securities and Futures Commission (SFC) within 3 months of the financial year end.
- B Employment of an auditor must be notified to the SFC within 14 days of the commencement of his employment.
- C The SFC must be notified in writing if its liquid capital falls below 120% of the Required Liquid Capital.
- D The financial year end must be notified to the SFC within 3 months of becoming a licensed corporation.

<7>.

Under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, under which of the following circumstances is an intermediary **NOT** obliged to issue a receipt?

- I Where CCASS eligible securities are transferred by the client into an account maintained with the intermediary's custodian.
 - II Where the intermediary is a registered institution.
 - III Where the client deposits money directly into the intermediary's bank account.
 - IV Where the money in the form of a cheque payable to the intermediary is given to a proper licensed account executive of that intermediary.
-
- A II and IV only
 - B I, II and III only
 - C I, III and IV only
 - D II, III and IV only

<8>.

Under the Securities and Futures (Keeping of Records) Rules, what is the **MINIMUM** period for which orders and instructions from clients must be kept?

- A 1 year.
- B 2 years.
- C 6 years.
- D 7 years.

<9>.

Which **TWO** of the following statements about the Investor Compensation Fund in Hong Kong are **INCORRECT**?

- I It covers all clients including professional investors of all intermediaries.
 - II It excludes Growth Enterprise Market (GEM) stocks.
 - III It covers retail clients only.
 - IV It covers all securities traded on the Stock Exchange of Hong Kong (SEHK).
- A I and II only
 - B I and IV only
 - C II and III only
 - D III and IV only

<10>.

Under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules, which of the following statements are **CORRECT**?

- I An intermediary conducting a transaction under a stock borrowing and lending agreement must issue a contract not later than T+3.
 - II An associated entity of a Hong Kong intermediary can have an arrangement with a broker in the United Kingdom (UK) whereby contract notes are issued according to UK law.
 - III Contract notes may be consolidated into the daily statement of account.
 - IV If a client is a client of both intermediary A and intermediary B, the two organisations can agree verbally as to who will provide the contract to the client.
- A I and IV only
 - B II and III only
 - C I, II and III only
 - D II, III and IV only

<11>.

Under the Securities and Futures (Client Money) Rules, what is the deadline by which a licensed corporation must segregate clients' money?

- A Immediately on receipt.
- B By the close of business on the day of receipt.
- C Within 1 business day of receipt.
- D Within 2 business days of receipt.

<12>.

Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which **ONE** of the following is **NOT** included by a licensed person engaged in exchange traded options business in the options client agreement?

- A The client's written disclosure of the identity of the account owner.
- B The client's agreement to provide the licensed person with margin.
- C The client's agreement to indemnify the licensed person against all losses resulting from a breach of the client's obligations.
- D The client's undertaking that he will not deal in options through another intermediary without prior notification.

<13>.

With respect to soft dollars under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which **ONE** of the following statements **CORRECTLY** describes some of the goods and services that an intermediary may receive?

- A Rental and general equipment for the office which houses the research team.
- B Portfolio and market analyses and the necessary hardware and software for such services.
- C General office equipment for securities trading.
- D Travel and accommodation for the employees.

<14>.

Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which **ONE** of the following General Principles (GP) underlies the concepts of 'prompt execution' and 'best execution'?

- A Diligence (GP 2).
- B Capabilities (GP 3).
- C Information for clients (GP 5).
- D Compliance (GP 7).

<15>.

A dealer in an intermediary receives a client order in the morning but accidentally forgets about it until the afternoon. In that period, he executes other deals. Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which **ONE** of the following General Principles (GP) is he primarily breaking?

- A Conflicts of Interest (GP6).
- B Capabilities (GP3).
- C Diligence (GP2).
- D Honesty and Fairness (GP1).

<16>.

Under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, which of the following provisions may be waived for intermediaries in case of Professional Investors?

- I Establishing their financial situation and investment objectives.
 - II Providing regular statements of account.
 - III Obtaining a written standing authority to operate a discretionary account.
 - IV Ensuring the suitability of a recommendation.
- A I and IV only
 - B II and III only
 - C I, II and IV only
 - D I, II, III and IV

<17>.

When receiving an order from a client, which **ONE** of the following statements is **INCORRECT** under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (SFC)?

- A Orders received by telephone must be tape recorded.
- B The use of mobile phones is not encouraged by the SFC.
- C Orders must be immediately time stamped.
- D Tapes of telephone calls must be kept for at least 1 month.

<18>.

Which of the following statements about the Management, Supervision and Internal Control Guidelines (ICG) issued by the Securities and Futures Commission (SFC) are **CORRECT**?

- I The ICG override the provisions of the Code of Conduct for Persons Licensed by or Registered with the SFC.
 - II If intermediaries fail to follow the ICG, it may reflect adversely on their fitness and properness to remain licensed.
 - III The ICG recommend that an independent compliance function should be established.
 - IV The ICG recommend the establishment of an internal audit policy and review function.
- A I and II only
 - B II and III only
 - C I, III and IV only
 - D II, III and IV only

<19>.

Which **TWO** of the following are objectives of the Listing Rules of the Stock Exchange of Hong Kong (SEHK)?

- I To ensure that all shareholders are treated equally and have the same rights.
 - II To ensure a fair and orderly issue and marketing of securities.
 - III To ensure that no single group of persons acting in concert owns more than 50% of any company.
 - IV To ensure that listed companies always pay a dividend to shareholders.
- A I and II only
 - B I and IV only
 - C II and III only
 - D II and IV only

<20>.

Which **ONE** of the following securities is **NOT** traded on the trading system of the Stock Exchange of Hong Kong (SEHK) (i.e. Automatic Order Matching and Execution Trading System or AMS/3)?

- A Exchange traded options.
- B H shares.
- C Debt securities of listed companies.
- D GEM securities.

<21>.

Which of the following statements about direct business (crossing of trades) are **CORRECT** under the Rules of the Stock Exchange of Hong Kong (SEHK)?

- I Details must be input to the system within 15 minutes of trading during the pre-opening session and trading hours.
 - II Direct business cannot be cancelled after input to the system.
 - III Details must be reported to the system at the end of the trading day.
 - IV Direct business can be cancelled if the intermediary gets permission from the SEHK.
- A I and II only
 - B I and IV only
 - C II and III only
 - D III and IV only

<22>.

Which of the following would **NOT** require a licence for conducting Type 1 (dealing in securities) regulated activity in Hong Kong?

- I Stock Exchange of Hong Kong (SEHK) options exchange participants.
 - II Automated Trading Systems (ATS) which provide services similar to a conventional stock exchange.
 - III Firms whose business is principal dealing.
 - IV Trust companies registered under the Trustee Ordinance.
-
- A I and III only
 - B II and III only
 - C I, II and IV only
 - D II, III and IV only

<23>.

What is the main purpose of the Stock Exchange of Hong Kong (SEHK) 's quotation rules?

- A To minimise sudden fluctuations in share price.
- B To reduce trading risk.
- C To comply with the Securities and Futures (Trading Procedures) Rules.
- D To comply with international standards.

<24>.

Which **ONE** of the following statements about participation of the Stock Exchange of Hong Kong (SEHK) is **CORRECT**?

- A To be able to trade on the SEHK, an exchange participant must be a shareholder in the exchange company.
- B A licensed corporation may obtain exchange participation by transfer from another participant, subject to the approval of the transfer by the Securities and Futures Commission (SFC).
- C A corporation licensed by the SFC is automatically granted trading rights and exchange participation.
- D An exchange participant must be licensed by the SFC and also hold a stock exchange trading right.

<25>.

Which of the following statements about the investor account service operated by the Hong Kong Securities Clearing Company Limited (HKSCC) are **CORRECT**?

- I Only corporate investors may open stock accounts.
 - II The investor account gives investors legal protection over their shareholdings.
 - III It enables investors to receive corporate communications directly from listed issuers.
 - IV Investors receive communications directly from the HKSCC.
-
- A I and III only
 - B III and IV only
 - C I, II and IV only
 - D II, III and IV only

<26>.

Under the securities borrowing and lending rules of the Stock Exchange of Hong Kong (SEHK) (Schedule 6), which **ONE** of the following is **INCORRECT**?

- A The exchange (SEHK) participant must collect collateral at the value of at least 105% of the securities loaned if they are for short selling.
- B The exchange (SEHK) participant must place the collateral in a segregated account.
- C The exchange (SEHK) participant must mark to market all securities borrowing and lending on real time basis.
- D Returns must be filed with the Inland Revenue Department by the borrower whenever a transaction is completed.

<27>.

With respect to short selling on the Stock Exchange of Hong Kong (SEHK), which **ONE** of the following statements is **INCORRECT**?

- A A short sale cannot be made below the best current ask price (except for some options market making activities).
- B Exchange participants must ensure that proper arrangements have been made for stock borrowing settlement before the short sale.
- C All securities listed on the Main Board of the SEHK may be sold short (except for a small number of securities issued by the PRC companies).
- D Exchange participants must indicate that it is a short sale when inputting it to the trading system.

<28>.

Which of the following statements about securities margin financing in Hong Kong are **CORRECT**?

- I The annual written client's authorisation to pledge stock must be combined with the client agreement.
 - II Securities margin financiers (licensed for Type 8 activity) can liquidate their securities collateral.
 - III Participants of the Stock Exchange of Hong Kong (SEHK) are not allowed to provide securities margin financing for options trading.
 - IV The minimum paid-up capital of a securities margin financier is HKD10 million.
- A II and IV only
 - B I, II and III only
 - C I, III and IV only
 - D II, III and IV only

<29>.

Which **ONE** of the following statements about securities advice is **INCORRECT**?

- A In general, an adviser should provide to the client a written copy of the rationale for advice given to him.
- B A journalist providing a deliberately misleading statement in his daily securities advice column cannot be prosecuted by the Securities and Futures Commission (SFC).
- C If an adviser deceives a client into making a worthless investment he may be liable to pay compensation to his client.
- D If an adviser deceives a client into making a worthless investment he may be prosecuted by the SFC.

<30>.

With respect to securities trading on internet in Hong Kong, which **ONE** of the following actions should an intermediary take to let his clients know about system failures?

- A The client agreement must state that failures are not the responsibility of the intermediary.
- B No mention need be made as system failures are a common occurrence.
- C The website must state how failures may affect orders and what the client should do in the case of failures.
- D The client internet letter made under the rules of the Stock Exchange of Hong Kong (SEHK) must state that the order will be taken if faxed or telephoned using a pre-agreed confidential identification.

<31>.

A corporation licensed for Type 1 regulated activity (dealing in securities), which is also an approved introducing agent as recognised under Securities and Futures (Financial Resources) Rules, is **NOT** subject to which of the following?

- I Securities and Futures (Clients Securities) Rules.
 - II Securities and Futures (Clients Money) Rules.
 - III The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (SFC).
 - IV Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.
-
- A I and II only
 - B III and IV only
 - C I, II and IV only
 - D I, II, III and IV

<32>.

With respect to offers of securities in Hong Kong, which of the following statements are **CORRECT**?

- I The content of prospectuses is in compliance with the Companies Ordinance (CO).
 - II The offer and distribution as part of a listing is covered under the Securities and Futures Ordinance (SFO).
 - III The offer and distribution of shares, units and other interests in collective investment schemes is covered under the CO.
 - IV There are both civil and criminal liabilities for misstatements in the prospectuses of Hong Kong incorporated and non-Hong Kong incorporated companies.
-
- A I and IV only
 - B II and III only
 - C I, II and III only
 - D II, III and IV only

<33>.

Which **TWO** of the following statements about options market makers are **CORRECT**?

- I Any options exchange participant can become a market maker.
 - II Each market maker must comply with the trading rules applicable to the Hong Kong Automated Trading System (HKATS).
 - III Market makers may also make markets in equity securities, subject to the approval of the Stock Exchange of Hong Kong (SEHK).
 - IV A market maker must respond to at least 50% of quote requests on average over two months.
-
- A I and II only
 - B I and III only
 - C II and III only
 - D II and IV only

<34>.

Under the Securities and Futures Commission (SFC)'s framework of risk management policies, procedures and management controls to be overseen by the board of directors for OTC business, which **ONE** of the following is **NOT** considered as an appropriate risk reduction technique?

- A The use of master agreements.
- B Collateralisation of transactions.
- C The use of third party credit enhancements, including guarantees.
- D The use of modeling techniques which are subject to back testing.

<35>.

A Stock Exchange of Hong Kong (SEHK) options trading exchange participant which is a non-clearing participant **MUST** arrange to have its transactions cleared through either of which **TWO** of the following?

- I Direct clearing participant.
 - II General clearing participant.
 - III Independent clearing participant.
 - IV Self-clearing participant.
-
- A I and II only
 - B I and IV only
 - C II and III only
 - D II and IV only

<36>.

Which **ONE** of the following is **NOT** a step which may be taken by a Stock Exchange of Hong Kong (SEHK) options trading exchange participant, without prior notice to his client, in the event that his client is declared to be in default?

- A To close, give up or exercise some or all of the client contracts to which that client is a party.
- B To decline to take further instructions from that client in respect of exchange business.
- C To dispose of all the client's collateral and retain for itself the balance of any proceeds after meeting in full the client's obligations to itself.
- D To enter into any contracts for the purpose of hedging risk to which it is exposed as a result of that client's default.

<37>.

Front running refers to the actions of an intermediary who:

- A telephones potential investors, persuading them to buy or sell securities.
- B trades for his own account knowing that he already has client trades to execute, thereby profiting from his knowledge.
- C puts excessive orders through the discretionary accounts of clients he manages.
- D effects a transaction in securities that involves no change in ownership of the securities.

<38>.

Mr. Chan believes that he has been disadvantaged by the actions of intermediary XYZ's involvement in insider dealing although XYZ has been found not guilty by the court. How can Mr. Chan try to pursue the case of his own loss?

- A He can sue XYZ for damages.
- B He can make a claim against the Investor Compensation Fund.
- C He can petition the Financial Secretary to have the case re-heard at the Market Misconduct Tribunal (MMT).
- D He can claim from XYZ's insurance under the Securities and Futures (Insurance) Rules.

<39>.

When the Securities and Futures Commission (SFC) is considering the level of a fine to be imposed on an intermediary, which **ONE** of the following factors would **NOT** be taken into account?

- A Its previous disciplinary record.
- B Whether a breach of fiduciary duty was involved.
- C The professional qualifications of the principals of the intermediary.
- D Whether the fine would jeopardise the continuation of its business.

<40>.

Mr. Chan, a director of JKL listed company, has been found by the Market Misconduct Tribunal (MMT) to have disclosed false information which has led to heavy dealing in the shares of another listed company XYZ. As a result Mr. Chan made a profit from the shares he held in XYZ. Which **ONE** of the following sanctions is **NOT** available to the MMT to impose on Mr. Chan?

- A Disgorgement of profits plus compound interest.
- B Payment of the MMT expenses.
- C Imposition of an imprisonment term of one year.
- D Disqualification of Mr. Chan from being a director of any listed company for a period of three years.

~End of the Examination Paper~

Answers

Question No.	Answer	Question No.	Answer
1	A	21	A
2	C	22	D
3	A	23	A
4	A	24	D
5	D	25	D
6	C	26	C
7	B	27	C
8	B	28	D
9	A	29	B
10	B	30	C
11	C	31	C
12	D	32	A
13	B	33	D
14	A	34	D
15	C	35	A
16	C	36	C
17	D	37	B
18	D	38	A
19	A	39	C
20	A	40	C