

Updating Your Study Manual

Instructions for Inserting Version 1.5

The followings serve as the instructions for updating **Topic 2: Relevant Statutory and Related Requirements** of Study Manual 2 for the Licensing Examination for Securities and Futures Intermediaries. Please be reminded that only the updated sections are provided for downloading. You may replace the relevant sections with this updated version for the study manual you possess.

Instructions:

1. Download and print out the following pages.
 2. **Remove** pages 2-3 to 2-4 and **Insert** new pages 2-3 to 2-4.
-

[Blank Page]

1 Financial resources

Introduction

- 1.1 The capital market relies on investors' confidence that all financial institutions conducting the business of dealing in securities, advising on securities and providing margin financing have sufficient financial resources for their businesses, and that financial transactions are promptly settled.
- 1.2 The capital adequacy requirements set by the SFC under the Securities and Futures (Financial Resources) Rules ('FRR') are designed to enable the SFC to make timely assessment of the solvency of licensed corporations and accurate assessment of the risks involved in any licensed corporation's regulated activities. This, in turn, can ensure more effective regulation of the industry and management of risks in the interests of investor protection and systemic stability.
- 1.3 While it is the accounts personnel in the licensed corporation that are responsible for the preparation of the various financial statements and returns, responsible officers have the overall responsibility to ensure due compliance and to inform the regulator promptly of any failure in compliance.

Financial resources requirements

- 1.4 A corporation must meet the capital requirement before obtaining a licence and continue to maintain sufficient paid-up share capital and liquid capital at all times for its business. The level of paid-up share capital and liquid capital required for each type of regulated activity is stipulated by the SFC under the FRR.
- 1.5 Financial requirements for authorized financial institutions ('registered institutions') are set by the HKMA. We shall confine our study to the FRR in the rest of this topic.

Capital requirements

- 1.6 Licensed corporations are required to maintain the following paid-up capital:

Dealing in securities:	
• where it provides securities margin financing	HK\$10,000,000
• others	HK\$5,000,000
Advising on securities (less for those that do not hold client assets)	HK\$5,000,000
Securities margin financing	HK\$10,000,000

Note that:

- paid-up share capital ranges from HK\$5 million to HK\$30 million depending on the regulated activity they conduct (refer to the figures given in Table A, section 5 of the FRR);
- where a corporation is licensed for more than one regulated activity, the capital requirement will be the highest amount for all such regulated activities; and
- some classes of licensed corporations, generally those that do not incur liabilities to clients, do not have paid-up capital requirements; for example, an approved introducing agent.

Liquid capital

1.7 Liquid capital ('LC') means the amount by which liquid assets exceed ranking liabilities:

$$\text{Liquid capital} = \text{liquid assets} - \text{ranking liabilities}$$

1.8 A licensed corporation must maintain at all times LC as follows:

Dealing in securities (there are additional financial requirements applicable to SEHK participants)	HK\$3,000,000
Advising on securities:	
• where it does not hold client assets	HK\$100,000
• where it holds client assets	HK\$3,000,000
Securities margin financing	HK\$3,000,000

[deleted]

1.9 The objective of defining the LC requirement is to enable the SFC and the licensed corporation to determine how much the assets of the corporation are worth in terms of the assets having to be realized to cover liabilities urgently; and to ensure that the LC is greater than the required liquid capital ('RLC') at all times.

1.10 The LC must be prepared or adjusted on a specific basis:

- the calculation is based on generally accepted accounting principles;
- the basis used must recognize the substance of transactions;
- the individual items must be calculated on trade dates and not on settlement dates; and
- liabilities not stated on the balance sheet will normally have to be included in the calculations unless the SFC can be otherwise satisfied.