

Updating Your Study Manual

Instructions for Inserting Version 1.1, 2003

The followings serve as the instructions for updating **Topic 3: Participants in the Markets** of Study Manual 8 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 3-3 to 3-4 and **Insert** new pages 3-3 to 3-4.
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Quick check 1:

Indicate whether each of the following statements is *true* or *false*:

- 1) All brokers must be licensed by the SEHK.
- 2) To trade securities on the SEHK trading system, brokers must be Exchange Participants.

Answer:

- 1) False; 2) True.
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1.3 Responsibilities

In the day-to-day interaction with investors and clients, brokers have a number of responsibilities that are regulated by the SFC. These responsibilities have been put in place to protect the interests of investors.

These responsibilities include:

- *Client agreement:* a broker must enter into a written agreement (in Chinese or English) with the client before rendering any services and must explain and provide a copy of the agreement to the client.
- *Know your client rule:* a broker must establish the identity of the client and retain a copy of the client's identity card. The broker must also gain a full understanding of the client's financial situation, investment experience and investment objectives.
- *Provision of information to clients:* a broker must issue a contract note to the client for securities transactions, provide a monthly statement and acknowledge the receipt of any securities.
- *Authority to pledge securities:* a broker must obtain written authority from a client to pledge any securities.
- *Segregation of clients' assets:* a broker is required to separate all client monies in a trust account and not to use the trust funds to repay debt or for any unauthorised activities. A broker firm is also required to register all client securities.
- *Adequate internal control procedures:* brokers must ensure they have adequate procedures to record orders and to maintain records.

- *Regulatory supervision:* a broker must comply with regulations set out by the SFC and agree to have regular routines and special inspections.
- *Compensation arrangements:* as an Exchange Participant, brokers' clients are protected by the Unified Exchange Compensation Fund from loss resulting from an Exchange Participant's default.

These requirements protect the interests of investors. Brokers must strive to fulfil these fiduciary duties. For example, the broker must strive to understand the needs of their client and provide recommendations that fit the client's objectives. Before making recommendations to a client, brokers should conduct appropriate research and examine relevant reference materials so that they can match their recommendations to the client's needs and objectives. The broker should also ensure that the client understands any potential risks and the broker should avoid or disclose any conflict of interests. Not only do these requirements constitute regulated responsibilities for the broker, they are also ethical responsibilities.

2 Traders

A trader is an individual or organisation (e.g. an investment bank) that acts as a principal rather than an agent. In other words, a trader acts on his/her own account or on behalf of their organisation in buying and selling securities. A trader may hold an inventory of securities. The securities held can be sold to clients by brokers or bought and sold at the market for the purposes of making a profit.

Traders are required to be licensed by the SFC and to comply with the same requirements as brokers as detailed above.

Quick check 2:

A trader buys and sells securities on behalf of clients only. *True or false?*

Answer:

False.
