ALLEN & OVERY

The Manager-in-Charge Regime: Ruffling feathers in the year of the Rooster?

Practical considerations for licensed corporations

INTRODUCTION

On 16 December 2016, the Securities and Futures Commission (**SFC**) issued a Circular to Licensed Corporations entitled Augmenting the Accountability of Senior Management (**Circular**).

At the heart of the Circular was the introduction of a Manager-in-Charge regime (**MIC Regime**). The SFC's intention behind the MIC Regime is to enhance, adapt, and supplement existing law and regulatory requirements imposed on the senior management of licensed corporations. The regime is expressed not to change regulatory or enforcement laws, nor does it change the licensing approval regime.

For an **overview** and discussion of the **MIC Regime** requirements, please see our bulletin "*The Manager-in-Charge Regime: An Overview*" available here.

This bulletin is part of a series on the MIC Regime, in which we discuss some key practical considerations for licensed corporations, managers-in-charge (**MIC**) and senior management generally, when preparing for the MIC Regime.

The **responsibilities** and **potential liabilities** MICs (and senior management) are exposed to and some **key mitigation measures** are provided in our bulletin "*The Manager-in-Charge Regime: Augmenting or extending senior management accountability?*" available here.

KEY PRACTICAL CONSIDERATIONS WHEN PREPARING FOR THE MIC REGIME

Licensed corporations will need to approach the implementation of the MIC Regime in varying ways and to differing degrees. The level of review, and revision (if any), to existing structures, reporting lines and policies/procedures will depend on the existing nature and size of each licensed corporation's business and its management structure. Nevertheless certain practical considerations should be considered by all licensed corporations. We consider some of those below.

MAPPING LEGAL ENTITIES AND DEFINING MIC ROLES

The MIC Regime and the SFC's views on senior management look at corporate governance on a legal entity basis, starting from the board, moving down to the MICs and responsible officers (**ROs**). This is consistent with the SFC's approach to licensing generally; the SFC licenses corporations, not groups. While this approach may work for many of the smaller, local licensed corporations, this presents challenges for licensed corporations that form part of larger, global groups that do not typically organise themselves around their legal entities or who have business lines that cross geographic and legal entity lines.

As a starting point, many larger groups will likely need to undertake a mapping exercise of their governance and reporting structure, much like that required when UK firms prepared for the Senior Managers and Certification Regime, to determine which businesses operate in which legal entities, and how the senior management/MICs fit into that structure.

The responsibilities of each prospective MIC must also be clearly understood and documented so as to determine whether they have sufficient seniority and authority. They must also be consistent with the operation of the business in practice. Particular care should be taken around the edges of responsibility where there is overlap and where there may be more than one MIC for a specific Core Function. If responsibility is not clearly allocated, then the risk arises that all MICs for that Core Function will be presumed responsible for any failures within it. In a worst case scenario, where a responsibility that should have fallen to a particular MIC falls between the cracks, there is a risk the SFC may take action against the Overall Management Oversight MIC or the board of the licensed corporation for a "flaw" in the governance structure of the licensed corporation.

The SFC expects licensed corporations to prepare and maintain a formal document setting out the management structure of the corporation, including an accurate description of the roles, responsibilities, accountability, and reporting lines of its senior management personnel. This is along the lines of the management responsibility map required under the UK Senior Managers and Certification Regime (although not requiring quite the same level of detail). While an express requirement of the SFC, this in our view is in any event an important document that should be carefully prepared for the above reasons; it will aid the SFC's understanding of the licensed corporation should they ever need to review the document in the context of the MIC Regime or otherwise.

For further discussion on identifying MICs, please see our bulletin "*The Manager-in-Charge Regime: An Overview*".

CLARIFYING AND SIMPLIFYING REPORTING LINES

It is important that licensed corporations ensure that relevant reporting lines within and across their legal entities are clearly understood by their staff. This is especially the case for licensed corporations that operate within a larger group where employees may report to multiple persons in several legal entities.

Although the SFC does not prescribe how licensed corporations organise themselves internally, licensed corporations may find that adjustments to their governance structures are needed where reporting lines, policies, and procedures are overly complex or unclear.

ENSURING MICS – AND ROS – ARE "IN CHARGE"

When a person is appointed as a MIC, the SFC will assume that he/she has the requisite seniority and authority in respect of the relevant Core Function(s) and, if things go wrong, will want to understand what was done to prevent and correct incidents. A MIC must therefore have sufficient authority and control over the relevant Core Function(s) to, first, impose and monitor adequate systems and controls to prevent such incidents occurring, and, second, make appropriate changes. Appropriate and effective reporting up to the MIC will be a prerequisite to achieve this. Failure to achieve this may have serious consequences for the licensed corporation and the MIC, where the MIC was unaware of an issue and therefore unable to take the necessary steps to head off the problem. This is something to which particularly careful attention should be paid; it is important to strike the right balance.

The SFC is concerned that, in some cases, ROs are not suitably senior and/or do not have the requisite authority to fulfil their roles. Accordingly, licensed corporations should take this opportunity to assess whether the appropriate individuals are approved as ROs and whether any changes should be made. Where changes are needed, the relevant applications should be made as soon as possible; in any event, a RO application for an individual who will be an Overall Management Oversight or Key Business Line MIC, but is not already a RO, must be submitted by 16 October 2017.

AVOID OVERBURDENING

The SFC expects that the Overall Management Oversight MIC(s) should be a RO for each regulated activity for which the corporation is licensed. Depending on the size of the licensed corporation's business this might be onerous without adequate support or indeed impractical, especially where the proposed MIC is not a person with direct experience of the relevant regulated activities. For this reason, it may be appropriate to appoint more than one individual to be the Overall

Management Oversight MIC(s) (and as a minimum, the MIC of each relevant business line must work closely with the Overall Management Oversight MIC(s)).

We consider this would be a reasonable approach for the SFC to take in appropriate circumstances. The SFC is rightly critical of overburdening. Licensed corporations (and the board) should in particular take careful note of the requirement in the Code of Conduct for Persons Licensed by or Registered with the SFC to ensure adequate resources to supervise the business.

An important component of the compliance requirement for MICs and how the various internal functions perform is a more collective approach. The SFC has articulated such an approach as follows:

"*Front-line business managers take on the responsibility for compliance, instead of solely relying on the compliance department…We [the SFC] are aiming for a regulatory outcome whereby compliance is not the prerogative of one department, and that the front line managers nurture a culture of acting honestly, fairly and in the best interests of their clients and the integrity of the market.*"[1]

A combination of appropriate MIC appointments and such a collective approach would go a long way to satisfying the governance needs of a licensed corporation (and the SFC's expectations and requirements) without overburdening the Overall Management Oversight MIC.

OUTSOURCING

Outsourcing continues to be a double-edged sword – an excellent way for a licensed corporation to reduce costs but one that introduces additional risks because of potential decreased oversight and control over the outsourced services.

It is clear that outsourcing continues to be permitted notwithstanding the MIC regime, but MICs of relevant Core Function(s) cannot outsource their responsibilities and accountability to the licensed corporation. This highlights the importance of a MIC in charge of a function that involves outsourcing (e.g. IT) to look carefully at, and monitor on an on-going basis, outsourcing arrangements and consider whether they have sufficient oversight over those arrangements, for example through site visits, periodic updated due diligence and so on. If the oversight falls short, they should make necessary adjustments. Failure to do so may result in regulatory criticism if and when an issue arises.

TRAINING FOR MICS AND TEAM MEMBERS

A representative of the licensed corporation to which a MIC has been appointed must sign and confirm to the SFC that the MIC has been informed of the particular Core Function(s) for which he/she is principally responsible. Licensed corporations should therefore consider training MICs, not only in respect of the SFC's expectations regarding their roles and their statutory and regulatory obligations, but also on the internal processes by which they will be enabled to meet those expectations.

Training should not be limited to MICs: an understanding of management (including MIC responsibility) and the requisite policies and procedures is critical to the ultimate aim of achieving good conduct governance and behaviour. Introduction of the MIC Regime and new processes and procedures is an opportune time to remind all staff, not merely senior management, of their own responsibilities and liabilities.

As usual, records of training and staff attendance should be maintained – not least to evidence and demonstrate good compliance. Non-attendance should be followed up.

INSURANCE

Ordinarily we would not expect licensed corporations to have to change their insurance coverage on the basis that liability under the Securities and Futures Ordinance and SFC codes and guidelines have not changed. However this will of course depend on the terms of a licensed corporation's current arrangements and therefore we suggest these be reviewed.

1 Julia Leung, Executive Director, Intermediaries: "Manager-in-Charge initiative Fostering Accountability and a compliance culture" Key note speech at AIMA APAC Annual Forum 2017 – 19 January 2017.

POLICIES, PROCEDURES, AND RECORD KEEPING

To the extent changes brought about by the MIC Regime impact policies, procedures, committee terms of reference, and management structure these should be updated to properly record the delegation of responsibilities and responsibilities for all Core Functions. This should align with responsibility mapping (see *Mapping legal entities and defining MIC roles* above) and may also trigger a need for updating the licensed corporation's "regulatory business plan".

CONCLUSION

Licensed corporations need to ensure that the structure of their governance is sufficiently clearly delineated, and that reporting lines in particular are properly set down. This is particularly relevant for licensed corporations housed within a wider group structure. Failure to adhere to this not only means that the licensed corporation is in danger of falling foul of the MIC Regime but, more broadly, its overarching proper governance requirements.

Within such structure, there needs to be real seniority and authority before the governance structure can work properly and efficiently. It is not enough to put in place model procedures and arrangements; they must be followed and seen to be followed, and all staff need to be fully aware of the requirements and their place in the overall framework.

It is vital that licensed corporations rise to the challenge of the MIC Regime as soon as possible.

If you would like further information about how Allen & Overy can assist your firm in relation to the MIC Regime, please do not hesitate to contact us.

CONTACT INFORMATION

Matt Bower
Partner – Hong Kong
Tel +852 2974 7131
matt.bower@allenovery.com

Charlotte Robins
Partner – Hong Kong
Tel +852 2974 6986
charlotte.robins@allenovery.com

Fai Hung Cheung
Partner – Hong Kong
Tel +852 2974 7207
fai.hung.cheung@allenovery.com

Andre Da Roza
Of Counsel – Hong Kong
Tel +852 2974 6980
andre.daroza@allenovery.com