

Exit Plan Submitted to SFC

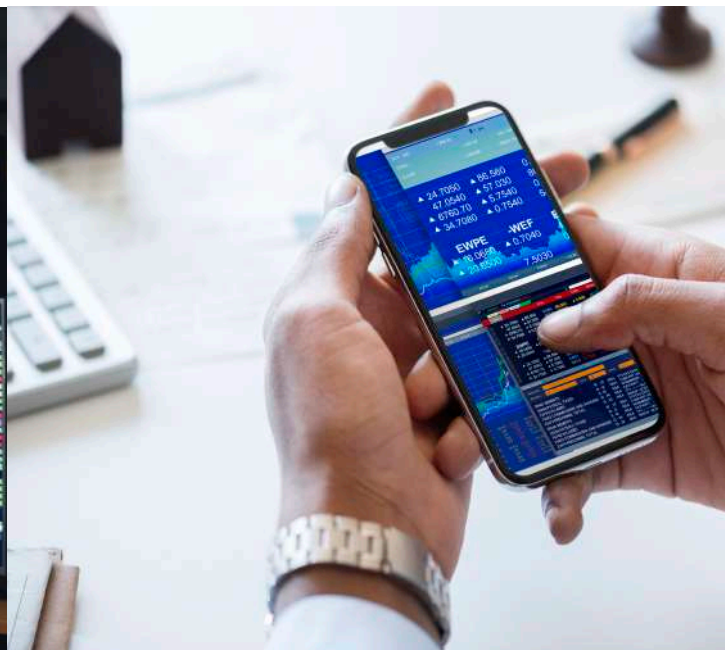
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In the recent years, the operation of the licensed corporation (“LC”) is disrupted by unpredictable and stress events and, in particular, the wealth management business of LCs is hit hard by the Covid-19 pandemic. Confronting hard times, some LCs have no other options but to wind down the business and surrender the licenses issued by the Securities and Futures Commission (the “SFC”).

The wind-down process

With regard to the wind-down of business, the SFC published a circular on 4 March 2022 (the “Circular”) to remind LCs who intend to discontinue the business to: -

- (i) request the SFC to suspend or revoke the license under section 195(1)(d) of the Securities and Futures Ordinance (Cap. 571) (the “SFO”);
- (ii) submit to the SFC its exit plan which lists out the details (see further elaborations below) of its orderly wind-down and closure of business when: -
 - (a) it intends to cease, or has ceased, to carry on regulated activities;
 - (b) it is required to suspend or cease to carry on regulated activities, including but not limited to the SFC’s exercise of its power under section 146(5)(a) and section 195(1)(c) of the SFO; or
 - (c) it is requested to do so by the SFC.



It is stated in the Circular that an LC's exit plan should be approved by its board of directors and endorsed by its substantial shareholders (the "SSHs") and controllers. In the exit plan, having due regard to the interests of its clients and the integrity of the market, the LC is required to provide sufficient details in respect of the process, responsible personnel and funding sources to secure an orderly closing down of the business in the relevant regulated activities of the LC. The details include, where applicable, the followings: -

- (i) **Timetable** with key milestones for an orderly closure of each of the LC's business lines of the relevant regulated activity;
- (ii) **Communication and follow-up actions with the LC's clients** with respect to: -
 - (a) the intended business cessation;
 - (b) the actions the clients will need to take (e.g. transfer their investment holdings to another intermediary, withdraw client money, collect physical scrips or redeem their holdings in funds managed by the LC or other intermediaries);
 - (c) timeline and corresponding fees and charges, if any;
 - (d) consequences if the clients do not take any action within the timeframe; and
 - (e) contact information of the LC's personnel to answer clients' enquiries concerning the intended business cessation;



- (iii) **Latest position of client interests connected with the LC** (e.g. the number of clients or ongoing deals engaged by the LC, the number of client securities and client money held by the LC and information about the portfolios or funds the LC manages);
- (iv) Where an LC is **a fund manager**, additional information about its business cessation should be provided which includes: -
 - (a) liaising with governing bodies and other service providers (e.g. administrators, custodians and auditors) of the fund to draw up an exit plan in accordance with the fund's constitutive documents;
 - (b) transferring the fund management role of the LC to another fund manager or liquidating investments in the fund and returning the proceeds to fund investors; and
 - (c) reminding fund investors about the risks associated with the redemption process (e.g. it may be prolonged if the fund investments are illiquid and redemption proceeds may be in the form of specie instead of cash);

- (v) Where the LC holds client assets or manages funds, the actions, funding and human resources earmarked for returning client assets and dealing with unclaimed client assets (e.g. engaging professional legal services with relevant expertise to arrange for the LC's application for paying such assets into the court by way of appointment of judicial trustee under provisions of the Trustee Ordinance), liquidating the funds or transferring its fund management role to another fund manager;
- (vi) **Designated personnel**, including at least one director of the LC, who have sufficient authority to act for the LC in executing the exit plan (including the operation of bank and custodian accounts) **and their names and contact information**;
- (vii) **Financial forecasts** including the estimated costs and the funding sources to finance and accomplish the exit plan and continue to comply with the capital requirement under the Securities and Futures (Financial Resources) Rules (Cap. 571N) until the LC's licence is revoked;
- (viii) **Submission of the LC's request to the SFC to revoke its licence** under section 195(1)(d) of the SFO;
- (ix) **Arrangements to submit the LC's financial statements and other documents**, which shall be made up to (and including) the date of cessation, not later than four months after the date of business cessation under section 156(2) of the SFO **together with other regulatory filings**, including financial returns, annual audited accounts and annual returns; and
- (x) **Arrangements in relation to the LC's books and records** (e.g. where they will be kept after revocation of the LC's licence and contact information of the persons in charge).



Unclaimed Client Assets

One of the critical steps of the wind-down process is to deal with or dispose of the client's assets which may render the entire process more lengthy and costly. In particular, if clients do not provide, or ignore to give, instructions to the LC on how to handle the clients' assets deposited with the LC despite its repeated requests or if a client is not contactable. That being the case, the client assets turn into unclaimed client assets. Cessation of business and surrender of license by the LC remains unsettled so long as the LC still holds client assets. In the circumstances, the LC is required to apply for payment of the unclaimed client assets to the judicial trustee appointed under the Trustee Ordinance pursuant to sections 56 and 62 thereunder. In *Re Gold Fund Securities Co Ltd* [2020] HKCFI 2884, it was ruled that for the purpose of application for appointment of judicial trustee to hold unclaimed client assets, Gold Fund Securities Co Ltd as an LC should establish that (i) the assets in question are held by it as trustee (i.e. as custodian in the context of an LC); and (ii) despite reasonable endeavours, the clients cannot be contacted or are unresponsive, or it is otherwise unable to obtain instructions as to how to deal with, dispose of or return the client assets.

In our experience, the application is susceptible to the requirements that the client assets represented by securities should be deposited into the court by physical share certificates.

The SFC's powers

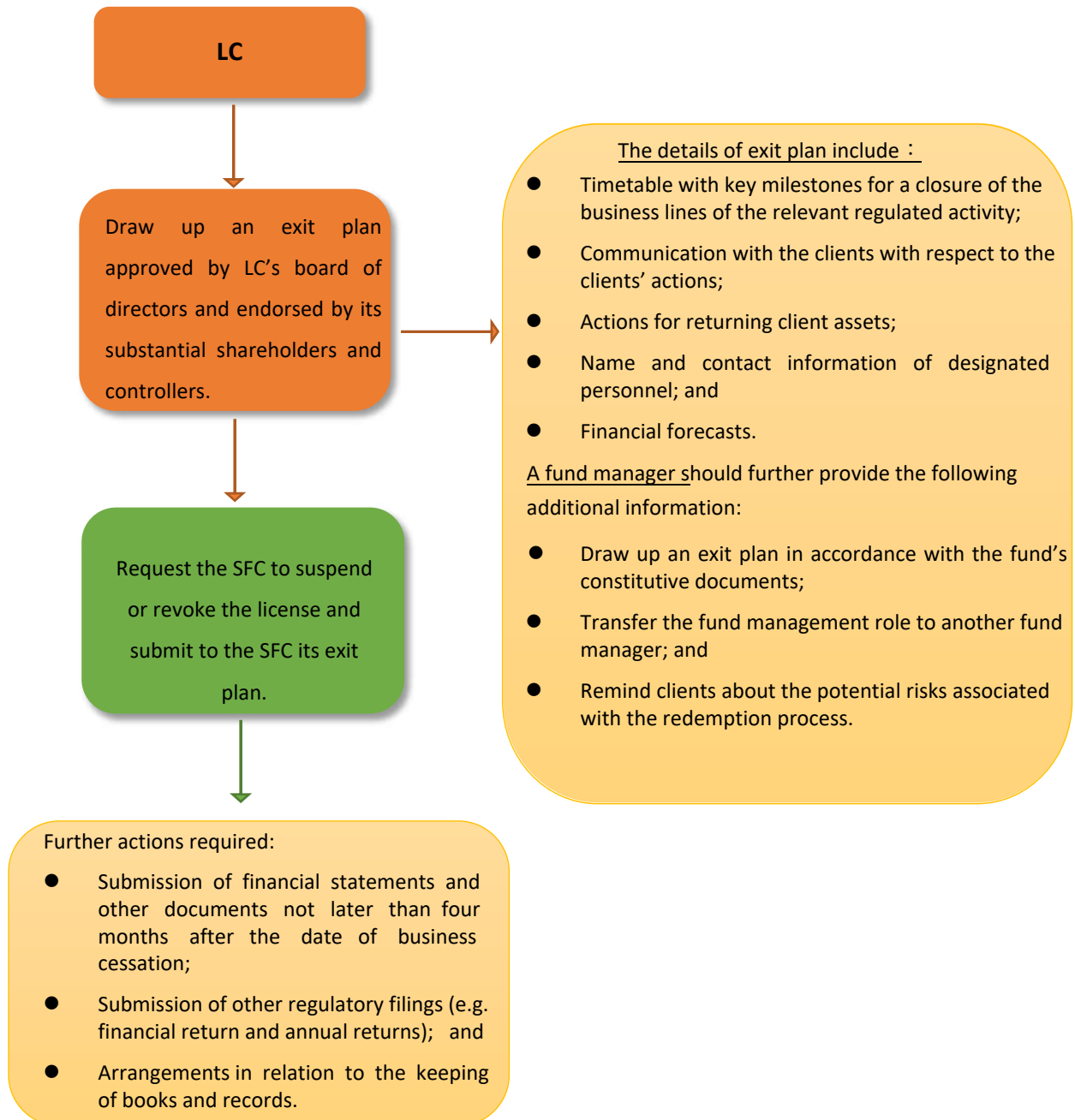
The SFC may request an LC to provide updates on the activation and implementation of its exit plan (e.g. regular updates of the latest positions of the client interests connected with the LC). The LC should also inform the SFC immediately of any major changes in the exit plan (e.g. changes in key milestones, timelines or designated personnel responsible for implementing the exit plan).

Where an LC fails to formulate a concrete exit plan or act promptly in accordance with its exit plan, the SFC will consider imposing conditions on the LC and other relevant persons, such as its SSHs and responsible officers, to require their immediate action to wind up the LC's business of regulated activities in an orderly manner. The SFC may also consider taking the following actions:

- (i) To issue restriction notices and appoint an administrator; or
- (ii) To take regulatory actions against the LC and other regulated persons concerned if their conduct does not meet the standards expected of them (e.g. failure to act in the best interests of clients).

For your information, the wind-down process is depicted in diagram below.

The Wind-down Process



This explanatory note is not, and should not be regarded as, legal advice. Should you have any enquiries, please seek specific advice from legal advisers.

Should you have any questions, please contact our partner Mr Lawrence Yeung at (852) 2854 3070 or by email at lawrence.yeung@ycylawyers.com.hk.