OPTIMA
Supporting Success

SFC Circular Summary
Measures to Deal with Disruptions Caused by Financial Distress and Insufficient Responsible Officers

On 4 March 2022, the SFC released a circular regarding Measures to deal with disruptions caused by financial distress and insufficient responsible officers. The SFC found that recent operational disruptions exposed some vulnerabilities in the ability of licensed corporations ("LCs"), particularly small and medium-size LCs, to cope with stress events.

The SFC has listed several expected standards to mitigate potential operational disruptions; Optima has reviewed and summarized key requirements below:

Information about all controllers and the shareholding structure of an LC

- The SFC issued a reminder that during "stress events", the Commission may reach out to an LCs Controllers (being any person in accordance with whose directions or instructions the LC is, or its directors, are accustomed or obliged to act). LCs are explicitly reminded to keep the information relating to its Controllers up-to-date so that the Commission may easily contact these individuals.
- If necessary, the SFC may ask for further information or confirmation of the identities of the controller from its directors, ROs, substantial shareholders and other management personnel.

Maintenance of a sufficient number of Responsible Officers ("ROs")

- Per SFC requirements, LCs must have no less than 2 ROs for each regulated activity, and at least one of them is an Executive Director ("ED") of the LC.
- LCs should critically assess the possibility and impact of its inability to maintain a sufficient number of ROs and incorporate such a scenario into its business continuity and exit plans.
- The following LCs should implement risk mitigation measures including identifying potential RO/ED individuals, reviewing notice periods of existing ROs, and appoint additional directors:
    a. LCs having only 2 ROs or 1 ED; and
    b. LCs that are wholly owned by an individual, who also acts as the sole director of the company.
- Once an LC becomes aware that it will have less than 2 ROs or no ED, it should immediately activate the business continuity plan and notify the SFC of the situation and provide remedial actions to appoint ROs or EDs with a concrete timeframe. Should there be a lack of concrete or feasible solutions provided to the SFC, the Commission may expect the LC to initiate and provide to the SFC its exit plan to ensure an orderly closure of business.

Maintenance of adequate financial resources

- SFC reminded that LCs must at all times maintain its required liquid capital and must notify the SFC within one business day should it fall below 120% of the required amount.

- If an LC has not been generating sufficient income to cover its operating expenses for a period of time and its excess liquid capital is projected to run out in less than 12 months, the SFC may ask the LC, its SSHs and Controllers to improve the LC's financial position (e.g. by injecting share capital and adopting cost-cutting and risk mitigation measures).
- If the financial position of the LC continues to deteriorate, the LC will be asked to provide a detailed funding plan, details of which are set out as Appendix A of the SFC's circular, a detailed exit plan (see below) or both, approved by its board of directors and endorsed by its SSHs and Controllers.
- Further, the SFC may require the LC and its Controllers provide written confirmation and undertakings for the purposes of risk mitigation and to protect client interests, the terms of which may include ceasing to accept new clients, client notifications, and the return of client assets.

Financial and operational dependency on another person

- The SFC understands that some LCs have arrangements in place for another party (SSHs or group company) to pay for its key operating expenses which are not charged back to the LCs as expense or management fees and therefore the financial positions reported in those LCs FRRs may not reflect their actual financial and operational capabilities.
- Should the SFC assess that a firm is unable to demonstrate that the paying parties or its SSH have adequate resources to continue to maintain LC's operations, the SFC may request the provision of financial information from the SSH/paying party, among other notification requirements.
- The SFC strongly encourages LCs to take appropriate measures to mitigate the risk of such dependencies on third parties, such as increasing share capital buffers and establishing these related scenarios in its Business Continuity Plans ("BCP").

Exit plans

- Where an LC does not or ceases to carry on any regulated activity for which it is licensed, it should request the SFC to revoke or suspend its licence for such regulated activity.
- In order to minimize the potential impact of an LC's business cessation on its clients and the market, it is prudent for an LC to plan ahead for such a scenario even when business cessation may not be imminent or anticipated.
- The SFC has published an "exit plan" template, affixed as Appendix B of its circular, to assist in the orderly wind down and closure of a LC's business. LCs are advised to submit its exit plan to the SFC when it intends to cease (or has ceased) to carry on regulated activities; is required to suspend/cease carrying on regulated activities by the SFC; or is simply requested to do so by the Commission.
- If an LC fails to establish a concrete exit plan or act promptly according to its exit plan, the SFC may consider imposing conditions on the LC to require its immediate wind up of its regulated activities business in an orderly manner.

Responsibility of senior management

- The Commission reminded LCs that its senior management assumes overall responsibility for the LC's contingency planning, including ensuring that sufficient financial/operation resources are secured for the effective execution of BCPs and exit plans, and will be available to the LC should the plans be activated.
- The SFC expects that Senior Management of an LC review its BCP and contingency planning test results at least annually to ensure that plans are sufficiently robust and remain effective to allow mitigation of stress events.
- An LC's contingency plan, including the exit plan, and any subsequent revisions should be properly documented. They should also be approved by the LC's board of directors, endorsed by its SSHs and Controllers and communicated to all relevant personnel. The SFC may require an LC to submit related documents should circumstances warrant.