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# SFC Publishes Consultation Conclusions On Amendments To The Code Of Conduct

## Introduction

In May 2012, the Securities and Futures Commission (**SFC**) published its consultation conclusions (**Consultation Conclusions**) on the proposals set out in its November 2011 consultation paper (**Consultation Paper**) on proposed amendments to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the **Code**) in relation to the establishment of a Financial Dispute Resolution Centre Ltd (**FDRC**) by the Government of Hong Kong to handle monetary disputes between financial institutions and their individual and sole proprietorship customers. It is the Government’s intention that the Code should be used to require persons licensed by or registered with the SFC (together **Licensees**), other than firms carrying on Type 10 regulated activity (i.e. provision of credit rating services), to engage in the FDRC process.

The FDRC-related amendments to the Code require Licensees to:

1. engage in the FDRC process (if the dispute is not resolved internally);
2. inform clients of their right to make complaint to the FDRC;
3. notify the SFC of all complaints referred to the FDRC and provide related information as requested by the SFC; and
4. act in good faith in cooperation with the FDRC.

These amendments to the Code came into effect on 19 June 2012.

The Consultation Paper also contained a number of other proposed amendments to the Code, which are not related to the FDRC. These have been remodelled significantly after the SFC took into consideration feedback from the industry. These amendments, which will take effect on 1 December 2012, include:

1. extending the retention period for telephone conversations for client orders to six months from three months;
2. banning the use of mobile phones to accept client orders in the workplace;
3. requiring written authorisation to allow third parties to place orders in client accounts;
4. requiring financial institutions to report to the SFC suspected breaches by clients of the market misconduct provisions in parts XIII and XIV of the Securities and Futures Ordinance; and
5. requiring financial institutions to permit their employees to provide expert witness services to the SFC and the HKMA when they wish to, unless there is a reasonable reason to prevent them from doing so.

This note contains a summary of the amendments to the Code. The [Consultation Conclusions](Conclusions_FDRC_21May2012.pdf) and [the revised version of the Code](code-of-conduct_oct2013.pdf) are available on the SFC website.

## Amendments In Relation To The FDRC

### Participation in the FDRC Process (Paragraphs 12A and 12.3(c))

A new Paragraph 12A has been inserted to require Licensees to comply with the FDRC process. Licensees will be bound by the outcome of that process, which may compensate for claims of up to HK$500,000.

Paragraph 12.3 sets out the obligations of firms in handling client complaints internally. Firms must:

1. handle client complaints in a timely and appropriate manner;
2. take steps to investigate and respond promptly to complaints; and
3. advise the client of further steps that may be taken if the complaint is not remedied promptly.

Paragraph 12.3(c) has been amended to require Licensees to inform clients of their right to refer complaints to the FDRC if internal resolution fails.

The amendment is based on similar requirements in the UK, Australia and Singapore. In the UK, firms must publish their internal complaints handling process and allow clients to refer disputes to the Financial Ombudsman Service if they so wish. In Australia, firms must follow internal dispute resolution procedures and advise clients of their right to refer complaints to an external dispute resolution scheme, from which resolutions are binding on both parties. In Singapore, a client may refer a complaint to the Financial Industry Disputes Resolution Centre Ltd only if it is shown that internal resolution had been attempted and failed.

### Enhancement of Complaints Handling Procedures (Paragraph 12.3(d))

The amendment to the complaints handling procedures requires Licensees to give consideration to the subject matter of a client complaint. If the subject matter of a complaint is relevant to other clients, or raises issues not specific to the complainant, the Licensee has to attempt to investigate and remedy the complaint even if other clients have not made complaints. In the UK, firms must consider any root causes or compliance failures that may have led to the client complaint and whether this warrants action with regard to clients who have not complained. In Australia and Singapore, systemic issues and market misconduct must be reported by the external dispute resolution scheme and the Financial Industry Disputes Resolution Centre Ltd respectively.

### Reporting Obligations (Paragraph 12.5(g))

New paragraph 12.5(g) obliges Licensees to provide the SFC with details of the outcome and any terms of settlement that result from the FDRC process, if so requested by the SFC.

Following overwhelming opposition to the proposal that Licensees should be required to notify the SFC when a client refers a complaint to the FDRC, the SFC decided not to proceed with it for the time being. It notes, however, that the FDRC is to ask firms to consent to the FDRC notifying and/or submitting information within its knowledge relating to systemic issues (which relate to issues that have affected or have the potential to affect other customers of the relevant firm or members of the public) and/or suspected serious misconduct to the SFC. The exchange of information between the FDRC and SFC will be governed by a Memorandum of Understanding and the FDRC will also publish data for research, evaluation or educational purposes.

The proposal to require Licensees to provide the SFC with documentation and information in relation to the FDRC process, if requested by the SFC, was not adopted.

### The “Full and Frank Disclosure” Provision in Dealing with the FDRC (Paragraph 12.6)

New paragraph 12.6 requires Licensees to make full and frank disclosure to mediators and/or arbitrators, and render all reasonable assistance to the FDRC process. Similar requirements exist in relation to the Financial Ombudsman Service in the UK and in Australia, and the Financial Industry Disputes Resolution Centre Ltd in Singapore.

## OTHER AMENDMENTS

These amendments have been added to the latest edition of the Code dated June 2012 but will not come into force until 1 December 2012.

### Order Recording Requirements (Paragraphs 3.9(b), (c) and (d))

#### Extension of Telephone Recording Retention Period

Paragraph 3.9(b) has been amended to require recordings of client orders made by telephone to be retained for a minimum of six months instead of the current three months. One reason behind this is to avoid imposing a three-month time limit on clients to make complaints. Secondly, the costs of operating recording systems have decreased since the three-month limit came into effect. Lastly, digital recording systems already allow firms to maintain records beyond six months for internal purposes.

For consistency, the SFC has also amended paragraph 1A of Schedule 4 and paragraph 37 of Schedule 6 to the Code to reflect the six-month minimum retention period requirement.

#### Prohibition on the Use of Mobile Phones for Receiving Client Orders

Paragraph 3.9(c) bans the use of mobile phones to take client orders when brokers are on the trading floor, in the trading room, in the usual place of business where orders are received or in the usual place where business is conducted. Licensees are required to have a written policy in place to explain and enforce this prohibition.

The SFC has not however proceeded with its original proposal which was to ban the use of mobile phones for taking client orders regardless of location. Instead the note to paragraph 3.9(c) states that the use of mobile phones for receiving client order instructions is strongly discouraged. Where orders are received on mobile phones (either verbally, by SMS or personal email) outside the trading floor/usual place of business etc., staff members are required to immediately call their licensed or registered person’s telephone recording system and record the time of receipt and order details. The use of other formats, for example writing by hand, to record details of clients’ order instruction and time of receipt may only be used if the licensed or registered person’s telephone recording system is unavailable.

The original proposal was opposed by the majority of respondents to the Consultation Papers who pointed out that such a ban in Hong Kong would inconvenience clients and would not be in their best interests. It was also suggested by some in the industry that such a ban would lower the competitiveness of Hong Kong and lead some customers to move to firms in other jurisdictions such as Singapore that do not have such blanket bans.

#### Retention of Internet Protocol addresses (i.e. IP addresses)

The Consultation Paper put forward a proposal requiring Licensees to record the IP address of any orders received through the Internet (e.g. by email) and to keep these records for a period of six months. This was suggested so as to confirm the identity of those making orders using the Internet. This proposal was criticised heavily by many in the industry as being an ineffective way to determine the identity of the person making an order. An IP address would only reveal the location of the computer and not the identity of its user. Furthermore, the fact that many companies use Network Address Translation means that many computers are given one IP address, meaning that it is impossible to determine which computer the order came from using the IP address alone. It was also pointed out by many in the industry that many people will make orders using public WIFI and an IP address would only be able to pinpoint this location and not the actual identity of its user.

The SFC will not therefore implement the proposal at this stage but reserves its position to consult again as technology improves. It also encourages firms to retain IP addresses wherever possible to ensure that its online transaction facilities are not a vehicle for market misconduct.

### Written Authorisation for Third Party Orders (Paragraph 7.1(a))

Paragraph 7.1(a) will require Licensees not to accept orders placed by a third party for a client account unless that third party is authorised by the client in writing to place the order. Additionally, paragraph 7.1(b) has been amended to delete the sentence “If an authority is granted to a person who is not an employee or agent of the licensed or registered person, the authority should state that the person is not an employee or agent of the licensed or registered person”.

### Reporting Client Irregularities to the SFC (Paragraph 12.5(f))

New Paragraph 12(f) of the Code will require firms to report to the SFC any material breach, infringement or non-compliance of market misconduct provisions set out in Part XIII (civil) or Part XIV (criminal) of the Securities and Futures Ordinance that they reasonably suspect may have been committed by their clients. When making such a report, firms will be required to give particulars of the suspected breach, infringement or non-compliance and relevant information and documents.

In response to a request for clarification as to the protocol for reporting to the SFC and the Joint Financial Intelligence Unit (JFIU) where both have jurisdiction, the Consultation Conclusions note that a report should be made to both with notification that the other body has also been informed of the suspected breach.

The original proposal in the Consultation Paper had a much broader scope, requiring firms to report any material breach or suspected breach of any law or rules. This was suggested to be too broad a requirement as it would mean that Hong Kong firms would have a responsibility to report any suspected breaches of foreign law happening extra-territorially and with no effect upon Hong Kong. It is for this reason that the Consultation Conclusions have made express reference to the market misconduct provisions of Parts XIII and XIV of the Securities and Futures Ordinance.

### Expert Witness Services (Paragraph 12.7)

This amendment will prevent firms from prohibiting members of their staff, without reasonable excuse, from performing expert witness services for the SFC or the HKMA. The words “without reasonable excuse” were added following concerns raised by respondents to the consultation. According to the Consultation Conclusions, what constitutes “reasonable excuse” will depend upon the facts of each case.

The SFC also reiterates in the Consultation Conclusions that the amendment will not impose a positive obligation on firms to provide their employees to the SFC or HKMA as expert witnesses. Rather, the provision is intended to ensure that employees who have no conflicts of interest, are qualified and willing to provide expert witness services to the SFC and the HKMA, are not unreasonably prevented from doing so by their employers.

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