CLIFFORD CHANCE

Briefing note 28 May 2012

SFC consultation conclusions on proposed amendments to the Code of Conduct

Key issues

- Amendments to the Code in connection with the establishment of FDRC
- Miscellaneous amendments to the Code

Introduction

On 20 May 2012, the Securities and Futures Commission (**SFC**) published its consultation conclusions on proposals to amend the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code**) in relation to the establishment of the Financial Dispute Resolution Centre Ltd (**FDRC**) and the enhancement of the regulatory framework. This follows from its two-month consultation[1] which ended on 9 January 2012. Our previous briefing on the consultation paper can be found here.

The FDRC will be responsible for the administration of the Financial Dispute Resolution Scheme (**FDRS**) to handle monetary disputes not exceeding HK$500,000 (per case) between financial institutions and their clients by way of mediation and, failing which, arbitration. It will commence operations in June 2012.

The amendments to the Code in connection with the establishment of the FDRC will come into effect on 19 June 2012 and the "miscellaneous amendments" to the Code, that are not specific to the FDRC but are instead of general application will come into effect on 1 December 2012.

Amendments to the Code in connection with the establishment of FDRC

(1) *Obligations under FDRS*

The Code will include a provision obliging licensees to participate in the FDRC process. This will require licensed or registered persons to become and remain members of the FDRS.

(2) *Enhancement of the Complaints handling procedures*

Under the amended Code, licensed or registered persons will be required to:

- seek to resolve complaints internally and, failing resolution, to inform clients of their right to make a complaint to the FDRC;
- consider the subject matter of the complaints and if the subject matter relates to other clients or raises issues which may be of broader concern, licensed or registered persons should take step to investigate and, where necessary, remedy these issues, notwithstanding that the other clients have not complained.

(3) *Enhancement of reporting obligations in paragraph 12.5 of the Code*

The SFC has decided not to proceed with the proposal to require licensed or registered persons to notify the SFC upon receipt of a complaint to the FDRC.

The SFC will however proceed with the proposal to require licensed or registered persons to provide details of any determination or settlement of complaints in connection with the FDRC process upon the SFC's request.

(4) *"Honest and Diligent Disclosure"*

The SFC initially proposed that the Code should require licensed or registered persons to make "full and frank disclosure" before mediators and/or arbitrators and to render all reasonable assistance to the FDRC process.

In light of the potential uncertainty that can be created by the phrase "full and frank disclosure" pointed out by the

[1] Consultation paper on proposals to amend the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission in relation to the establishment of the Financial Dispute Resolution Centre Ltd and the enhancement of the regulatory framework, November 2011

industry, the SFC will instead use the phrase "honest and diligent disclosure" which will be consistent with General Principle (**GP**) 1 (Honesty and fairness) and GP 2 (Diligence) of the Code.

This appears to mean that, rather than disclosure having to be full and frank (a phrase is well-understood in the context of ex parte applications to the court), it will be sufficient for the disclosure to be not misleading, balanced and reasonably thorough and undertaken with care to ensure no particularly material information is omitted.

Miscellaneous amendments to the Code

(5) *Extension of notification requirement in paragraph 12.5 of the Code of Conduct*

The SFC initially proposed that the duty on licensed or registered persons in paragraph 12.5 of the Code to report any actual or suspected material breach, infringement or non-compliance with applicable law, rules, regulations and codes by themselves or their employees should be extended to the reporting of actual or suspected breaches by their clients as well.

Most respondents objected to this proposal.

In addressing respondents' concerns with contractual duty of confidentiality to clients, the SFC has taken the view that the public interest exemption to the common law duty of bankers' confidentiality would apply.

Some respondents were concerned that the Code, having no force of law, would not protect them from potential liability to clients that may arise as a result of their disclosure of clients' confidential information to the SFC. Respondents were also concerned that the SFC is not an "*authorised officer*" under the Drug Trafficking (Recovery of Proceeds) Ordinance and Organized and Serious Crimes Ordinance and a concurrent obligation to report both to the SFC and the Joint Financial Intelligence Unit may amount to "tipping off" and may raise questions of criminal liability for a firm. The SFC considers such concerns are misplaced.

Nevertheless, in response to the concerns that the scope of the "whistle blowing" obligation is too broad, the SFC has modified the proposed paragraph 12.5 to the effect that licensed or registered persons are only required to make reports to the SFC if they suspect or believe that their clients may be involved in market misconduct or offences as defined under Part XIII and Part XIV of the Securities and Futures Ordinance. The list of these offences can be found in Appendix I.

(6) *Prohibition of the use of mobile telephones for receiving client orders*

The majority of respondents opposed the proposal to ban the use of mobile telephones for accepting client orders.

The SFC has therefore decided to limit the scope of the prohibition on the use of mobile phone bans for accepting client orders only to their use when on the trading floor, trading room, usual place of business where order is received or usual place where business is conducted. Where client order instructions are received on mobile telephones outside of the trading floor, trading room, usual place of business where order is received or usual place where business is conducted, the SFC expects staff members to immediately call back to the firm's telephone recording system to record details and time of the order.

The use of other formats (e.g. in handwriting) to record details of clients' order instructions and time of receipt should only be used if the licensed or registered person's telephone recording system cannot be accessed.

(7) *Extension of the telephone recording retention period*

The SFC will proceed with the proposal to extend the retention period for telephone recordings from at least three months to six months.

(8) *Retention of Internet Protocol address (IP address) records*

The SFC Consultation Paper proposed to require licensed or registered persons to retain the IP address records of their clients for all online transactions for a minimum of six months.

Most respondents objected to this proposal and queried the effectiveness of using IP addresses to establish the identity of a person originating an order over the internet. The SFC has decided that it will not implement this proposal at this stage but reserves its position to consult again as technology develops.

The SFC encourages all firms to retain IP addresses where possible to ensure that its online trading facilities are not a vehicle for market misconduct.

(9) *Requirement on third party authorization in writing*

The SFC will proceed with the proposed amendment to paragraph 7.1 of the Code to require licensed and registered persons not to accept orders placed by a third party for a client's account unless that third party is authorized by the client in writing.

(10) *Performing expert witness services*

The SFC proposed to insert a new provision in the Code requiring licensed and registered persons not to prohibit their staff from performing expert witness services for the SFC or the Hong Kong Monetary Authority.

In response to concerns raise by the industry, the SFC has amended the provision to include the phrase "without reasonable excuse" to give firms a discretion to decide on a case-by-case basis whether there are reasonable grounds to prohibit an employee from acting as an expert witness.

Appendix 1 – Offences as defined under Part XIII and Part XIV of the SFO

Cap 571 s 270 Insider dealing

Cap 571 s 274 False trading

Cap 571 s 275 Price rigging

Cap 571 s 276 Disclosure of information about prohibited transactions

Cap 571 s 277 Disclosure of false or misleading information inducing transactions

Cap 571 s 278 Stock market manipulation

Cap 571 s 291 Offence of insider dealing

Cap 571 s 295 Offence of false trading

Cap 571 s 296 Offence of price rigging

Cap 571 s 297 Offence of disclosure of information about prohibited transactions

Cap 571 s 298 Offence of disclosure of false or misleading information inducing transactions

Cap 571 s 299 Offence of stock market manipulation

Cap 571 s 300 Offence involving fraudulent or deceptive devices, etc. in transactions in securities, futures contracts or leveraged foreign exchange trading

Contacts

Martin Rogers
T: +852 2826 2437
E: martin.rogers@cliffordchance.com

James Wadham
T: +852 2825 8837
E: james.wadham@cliffordchance.com

Donna Wacker
T: +852 2826 3478
E: donna.wacker@cliffordchance.com

Lisa Chen
T: +852 2826 2438
E: lisa.chen@cliffordchance.com