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# SFC Consultation On Proposed Amendments To The Code Of Conduct

## Introduction

The Securities and Futures Commission (**SFC**) has published a consultation paper (**Consultation Paper**) the main focus of which is 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 proposed 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 and the Hong Kong Monetary Authority (**HKMA**) to engage in the FDRC process.

The Consultation Paper also contains a number of other proposed amendments to the Code, which are not related to the FDRC. These relate to changes to the customer order recording and retention requirements; a requirement for written authorisation for acceptance of third party instructions; extending the self-reporting obligations to breaches or non-compliance by clients; and new provisions regarding expert witness services.

The proposed 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.

This note will summarise the proposed amendments to the Code as set out in the [Consultation Paper](https://www.sfc.hk/sfcConsultation/EN/sfcConsultFileServlet?name=fdrccoc&type=1&docno=1) ([see archive](openFile.pdf)) which is available on the SFC website.

References to paragraphs of the Code refer to the proposed amendments as set out in Appendix A to the Consultation Paper.

## Proposed Amendments In Relation To The FDRC

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

Paragraph 12A would be inserted to require licensees to comply with the FDRC process. Licensees would be bound by the outcome of that process, which may compensate for claims of up to HKD$500,000.

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

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

Paragraph 12.3(c) would be amended to require licensees to inform clients of their right to refer complaints to the FDRC if internal resolution fails.

This proposal 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.

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

The proposed amendment to the complaints handling procedures would require 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 would have 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 (Paragraphs 12.5(f), (g) and (h))

These amendments will oblige licensees to:

* notify the SFC when a client refers a complaint to the FDRC;
* provide all documentation and information in relation to the FDRC process as requested by the SFC; and
* provide the SFC with details of the outcome and any terms of settlement that result from the FDRC process.

Similar requirements exist in the UK, Australia and Singapore with regard to firms reporting to the Financial Services Authority, Australian Securities and Investments Commission and the Monetary Authority of Singapore respectively.

### The “Good Faith” Provision (Paragraph 12.6)

This addition to the Code 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 Proposed Amendments

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

#### Extension of Telephone Recording Retention Period

Paragraph 3.9(b) would be 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.

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

Paragraph 3.9(d) would ban the use of mobile phones to take client orders. Instead, client orders that would be received on mobile phones should be diverted to the firm’s telephone recording system. If the market is closed at the time of the call, clients should leave their order instructions on the firm’s recorded voice mailbox for execution on the next trading day. The purpose behind this amendment is to eliminate a loophole whereby the telephone recording requirements of paragraph 3.9(b) may be bypassed.

#### Retention of Internet Protocol Address Records

Paragraph 3.9(c) would require firms to record the Internet Protocol (**IP**) address of persons who make online transactions with them. These records would be required to be maintained for a minimum of six months. IP addresses can be circumstantial evidence that can be used to determine cases of unauthorised access of client accounts. Internet service providers may use them to help establish the identity of any person who attempts an unauthorised access. IP addresses are therefore part of the audit trail.

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

If amended, this paragraph would require licensees to accept orders for a client account placed by a third party only if that third party is authorised by the client in writing to place the order. Additionally, paragraph 7.1(b) would be amended so that the client authorisation would no longer have to state that the third party is not an employee or agent of the licensee.

### Reporting Client Irregularities to the SFC (Paragraph 12.5(a)(iii))

This amendment to the Code will require firms to report to the SFC any actual or suspected material breach, infringement or non-compliance with applicable law, rules, regulations and codes by their clients. While paragraph 12.5 already requires firms to report irregularities in relation to themselves and their employees, this amendment is proposed to:

1. assist the SFC in identifying irregularities committed by clients, as firms and their front-line staff are believed to be in the best position to detect them; and
2. protect firms from irregularities committed by their clients that might otherwise implicate them.

The Consultation Paper argues that firms are already under similar obligations under the Drug Trafficking (Recovery of Proceeds) Ordinance (CAP 405) and the Organized and Serious Crimes Ordinance (CAP 455), and the amendment therefore would not be too burdensome.

### Expert Witness Services (Paragraph 12.7)

This amendment would prevent firms from prohibiting members of their staff from performing expert witness services for the SFC or the HKMA. However, this does not mean that firms have a positive obligation to provide their employees to the SFC or HKMA as expert witnesses. Rather, prohibition of an employee from expert witness service without reasonable excuse would reflect negatively on the employer’s fitness and properness.

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