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# SFC Publishes Frequently-Asked-Questions on Chinese Walls Requirement

## Introduction

The Securties and Futures Commission (**SFC**) has published a [Frequently-Asked-Questions](http://www.sfc.hk/web/EN/faqs/intermediaries/supervision/corporate-finance-adviser-code-of-conduct/2013-04-12.html) (**FAQ**) [[archived copy](FAQ.pdf)] on its website to clarify the meaning of and assist compliance with the Chinese walls requirement under section 4.3 of the Corporate Finance Adviser Code of Conduct (the **Code**).

Section 4.3 of the Code provides that where a corporate finance adviser which is licensed or registered under the Securities and Futures Ordinance (a **CFA**) is part of a professional firm or group of companies undertaking other activities, e.g. auditing, banking, research, stock-broking and fund management, the CFA should ensure that there is an **effective system of functional barriers** (**Chinese walls**) to prevent the flow of information that may be confidential or price sensitive between the corporate finance activities and the other business activities. It specifies that the system should include physical separation between, and different staff employed for, the various business activities.

The FAQ covers the following:

* The importance of “Chinese Walls”;
* Person responsible for compliance;
* When a CFA is deemed to have confidential information or price sensitive information;
* The importance of physical separation;
* Other measures to maintain “Chinese Walls”; and
* “Wall crossings”.

## The importance of “Chinese Walls”

In addition to the duty not to disclose confidential and/or price sensitive information to clients, CFA firms and its staff also have a broader duty to act fairly and in the best interests of their clients, avoid conflicts of interest situations and ensure the fair treatment of its clients. [[1]](#footnote-27) The rationale behind Chinese Walls therefore is that any price sensitive and/or confidential information which a CFA has through advising on corporate finance/mergers and acquisitions should not be disclosed inappropriately or otherwise used by the firm or its staff, whether for its own benefit or for the benefit of other clients.

Any disclosure of such information should be restricted to people who “need to know” it, e.g. in order to enable the firm to provide its services to the relevant corporate finance client. The existence of Chinese Walls is essential to reduce the risk of confidential/price sensitive information being misused or wrongly disclosed, which also risks contravention of the laws on insider dealing by preventing the spread of information between different departments of CFA firms.

## Person responsible for compliance

The managing director, the board of directors, the chief executive officer or other senior operating management personnel (collectively, **Senior Management**) of a CFA are responsible for ensuring compliance with the Chinese Walls requirement. Senior operating management personnel refers to those in a position of authority over a CFA’s business decisions. The Senior Management should ensure that effective Chinese Walls are in place and careful consideration is given to where Chinese Walls are placed within the organisation and which staff are grouped together.

## “Confidential information or price sensitive information”

It is for each CFA to determine when it has confidential/price sensitive information which has to be protected. Generally, the SFC would expect **non-public** corporate finance information about a client to be confidential to that client.

## The importance of physical separation

Section 4.3 requires that the effective system of functional barriers should include physical separation between, and different staff employed for, the various business activities. Where a CFA carries on different businesses, physical separation helps reduce the risk of accidental leakage and disclosure by confining information to a limited number of persons within a limited physical area.

Although physical separation is a necessary element in an effective system, it is not of itself enough to constitute effective Chinese Walls. The SFC also accepts that it is not necessary for corporate finance staff to be permanently physically separated from all other staff on the private side which normally refers to groups of staff who deal directly with clients and have access to inside company information which is not available to the public. However, corporate finance staff must always be physically separated from non-private side staff (e.g. stock-broking staff and proprietary traders).

## Other measures to maintain “Chinese Walls”

In addition to physical separation, the senior management of CFA firms should look at the totality of their information-handling procedures and controls to assess whether they have an effective system.

In determining the nature and extent of measures a CFA firm should adopt, it should consider:

* The functions and roles of the staff on the private side that the firm plans to group together;
* Whether the features of specific transactions require the information to be held confidential within a specific team (whether facilities for temporary separation are necessary for particular deals or teams within the Chinese Walls); and
* Whether physical separation should be a permanent arrangement between particular business units (permanent physical separation between a firm’s corporate finance business and its proprietary traders is always necessary)

In addition to physical separation, the senior management should also consider the following areas that can form part of the Chinese Walls:

* Implementing a compliance culture and attitude
* i.e. how to promote a compliance culture that values protection of client information e.g. through training, disciplinary action against staff in breach of policies, management example, etc;
* Conflicts management controls and procedures
	+ Conflicts management arrangements can help mitigate risks of information mis-use or disclosure. Conflict checks should be undertaken as soon as possible for new transactions or clients and in any event, before any pitch for a specific mandate, substantive discussions, or presentation to an appropriate business approval committee. It may also be necessary to obtain informed consent from relevant clients when conducting a conflict check;
* Ways of handling/storing information
	+ For example firms should consider implementing “clear desk” policies for paper documents and meetings where corporate finance information is to be discussed should be held in private. The use of code names for projects and deals should also be considered;
* Physical controls in office setting
	+ Examples include ensuring that visitors are accompanied at all times, holding client meetings only in client meeting rooms, and where necessary, holding internal discussions on matters that should not be discussed in shared office space in “Chinese box” rooms to which access is limited to specific deal team members;
* IT infrastructure
	+ Examples of IT controls that may be implemented include a printing system which only allows employees to print materials sent from their computers by swiping a personal access card on the printer’s control device and setting up segregated computer drives for individual deal teams for each transaction with restricted access and password-protected filing systems. Emails containing confidential information should be required to be encrypted;
* Support functions
	+ All staff, including those in support functions, should be subject to firms’ information-handling procedures and controls. Firms which rely on physical separation of it their corporate finance business from their other activities should also consider whether and how that separation is reflected in the relevant support functions;
* Insider lists and “above the wall” staff; [[2]](#footnote-32)
	+ Firms should maintain and regularly review lists of their employees with access to inside information relating, directly or indirectly, to corporate finance information, whether on a regular or occasional basis. The SFC recognises that some senior management staff and staff responsible for compliance will have access to corporate finance information, but without themselves being part of a firm’s corporate finance business. Appropriate controls should be implemented to ensure that these staff comply with the firm’s and their own information-handling obligations;
* Training
	+ Firms are required to train staff on the relevant legal and regulatory requirements and the firm’s procedures and controls to meet those requirements. Refresher training should be implemented from time to time.

## “Wall crossings”

Corporate finance information may sometimes be legitimately disclosed by persons within a firm’s corporate finance business unit to staff on the non-private side of a Chinese Wall and sometimes even to other clients, for example, to conduct "market soundings" in a placing (“Wall-crossing” or bringing someone “Over-the-wall”). However, such disclosures must be subject to proper controls, and must not be made if such staff or client has expressly or impliedly refused to be “brought across the wall”. In particular, this must be done on a "need to know" basis (e.g. because the recipients’ views on a transaction are needed) and the recipients must be subject to a duty of confidentiality such that they cannot use or disclose the information for their own or others benefit until the information becomes public or otherwise ceases to be price-sensitive. Firms should keep proper records of such wall crossings.

## Conclusion

It is for each CFA firm to decide what procedures and controls it should have to maintain an effective system of functional barriers in accordance with section 4.3.

The FAQ includes a reminder that the guidance is not directed at what firms must do to comply with the terms of the “Chinese Wall defence” to insider dealing. Also, corporate finance is not the only business in which client confidential information or price sensitive information arises. Therefore, all firms and staff should protect client confidentiality and prevent mis-use of confidential information in all circumstances.

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1. General Principles 1 & 6 of the Code of Conduct for Persons Licensed by or Registered with the SFC [↑](#footnote-ref-27)
2. Refers to Senior Management staff responsible for regulatory compliance that have access to corporate finance information, but without themselves being part of a firm’s CFA business. [↑](#footnote-ref-32)