THE LAW SOCIETY OF HONG KONG 香港律師會

SFC 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

Question 1
Do you agree that firms should be obliged to inform clients of their right to make complaints to the FDRC if the complaints cannot be resolved internally?

Law Society's response:

We agree that clients should be informed of their right to complain about firms to the FDRC. We assume, from the draft amendment to paragraph 12.3(c), that the Commission intends a firm to make that disclosure once it has investigated the complaint and decided that the complaint has (in its eyes) no merits, since if the firm accepts a complaint and remedies it, there should be no need for further action. However, if the Commission intends clients always to be told about their right to complain to the FDRC, we would suggest that firms be able to make an up-front disclosure about this at the outset of the complaints process or in their agreements/terms of business.

Question 2
Do you think that firms should consider the subject matter of a complaint received from a client and if the subject matter of the complaint relates to other clients, or raises issues of broader concern, firms should take steps to investigate and remedy these issues notwithstanding that the other clients may not have filed complaints with the licensed or registered persons and/or the FDRC?

Law Society's response:

We agree that a firm should consider the subject-matter of any complaint to see whether it raises broader issues that should be investigated and addressed. The reference to complaints that 'relate to other clients' is unclear since we would expect a complaint to be about the firm's conduct with respect to the complainant, not other clients. If the Commission simply intends to capture complaints which raise issues that might also apply in relation to other clients, then this is already within the concept of 'issues of broader concern'.

We would also suggest changing the word 'remedy' to 'address'. 'Remedy' suggests that a complaint is always valid. This is often not the case – complaints may or may not be valid. If a firm believes a complaint is not valid, then it still needs to 'address' the complaint by responding to the complainant (explaining, as needed, why it does not accept the complaint, etc.), but there will be nothing to 'remedy' (as far as the firm is concerned).

Of course, the firm may be wrong in its view, which is why firms need to tell clients about the FDRC. (In fact, we would make the same point about the current reference to 'remedied' in 12.3(c), which we suggest be amended to refer to 'addressed'.)

Question 3
Do you agree that:
(a) firms should notify the SFC upon receipt of a complaint to the FDRC; and
(b) firms should provide the documentation and information referred to in paragraph 21(b) and (c) above?

Law Society's response:

We do not agree with the proposed requirement for firms to notify the Commission upon receipt of a complaint to the FDRC.

We assume that the Commission's thinking is that complaints that go to the FDRC are likely to raise regulatory issues which the Commission ought to know about in case they merit supervisory/disciplinary action against the firm or its staff. We make the following points on this:

First, while this may be true in some cases, it will not be true in every case.

Second, presumably the Commission would look at every complaint sent to it in order to determine if it needed to do something – which may not be the best use of the Commission's resources if it turned out that many complaints were invalid or did not require regulatory action.

Third, in respect of complaints that merit supervisory/disciplinary action, firms are already subject to a self-reporting obligation, and where a complaint is justified, the Commission will be able to both access the findings of the FDRC and require firms to provide documentation and information. Accordingly, we doubt if any useful purpose can be achieved by requiring firms to report complaints with the Commission.

Question 4
Do you agree that licensed or registered persons should make full and frank disclosure before mediators and/or arbitrators, and render all reasonable assistance to the FDRC process?

Law Society's response:

We agree that firms should co-operate with and deal with the FDRC in good faith. However, on the drafting, we suggest the Commission consider the need for the proposed

paragraph 12.6, given the obligations imposed by paragraph 12A. In any event, we would suggest that paragraph 12.6 be merged into paragraph 12A for simplicity.

Question 5
Do you agree that telephone recordings of order instructions received from clients should be retained for at least six months?

Law Society's response:

We have no comments on this, but would ask the Commission to look carefully at the actual costs that would be incurred by firms (across a range of sizes) to ensure that its costs-benefits analysis does support extending the time that telephone recordings are required to be kept.

Question 6
Do you agree with the proposed prohibition on using mobile phones for receiving order instructions from clients? If not, do you have any alternative proposals that would achieve the same objective (e.g. permit the use of corporate mobile phones that record all incoming and outgoing calls)?

Law Society's response:

We agree that the Commission should be concerned about the deliberate use of mobile phones to by-pass firms' telephone-recording systems. Nevertheless, it would be helpful to understand from the Commission how widespread it believes this problem to be. We could understand a ban if the problem were widespread. It should also be remembered that the use of mobile phones is not just a convenience for account executives, it also helps clients. Accordingly, we believe that it would be helpful to clients if alternative proposals to a complete ban could be explored (such as corporate mobile phones linked to firms' recording systems, which we understand have been adopted in other markets).

Question 7
Do you agree with the proposed IP address record keeping requirement?

Law Society's response:

We have no comments on this.

Question 8
Do you agree with the proposed amendments to paragraph 7.1 of the Code?

Law Society's response:

Our only comment is to ask the Commission to clarify that 'a person designated by the client' is someone other than an employee of the client (if the client is other than an individual).

Question 9
Do you agree with the proposed extension of the reporting requirement?

Law Society's response:

We do not agree with the proposed extension of the reporting requirement in paragraph 12.5 of the Code for a number of reasons.

Firms normally owe their clients duties of confidentiality (whether by implication of Hong Kong law or as a matter of contract). Sometimes that duty will not cover information about a client's misconduct on the basis that the 'public interest' requires/allows disclosure. However, the courts have generally restricted this to information about crimes, fraud or when national security is at issue – e.g. see the discussion in *Lai Mei Chun Swana v Lai Chung Kong* [2011] HKCU 742 at 65-68.

The Commission's proposal appears to go beyond this requiring firms to report material breaches by clients of 'any law, rules, regulations and codes' administered by the Commission, the 'rules of any exchange or clearing house' and the 'requirements of any regulatory authority' or 'where [the firm] suspects any such breach'. While reports of actual serious breaches (e.g. criminal offences – but see below) may be outside a duty of confidentiality, this will not be true of every breach. Nor may it be true for suspected breaches which turn out not to be breaches at all. If the obligation to report this information were required by the Securities and Futures Ordinance (SFO) or subsidiary legislation (or in response to the Commission's exercise of its formal investigatory powers under Part VIII of the SFO), firms would clearly be protected (at least under Hong Kong law) from challenges for breach of duty (e.g. see s.380(3), SFO) – but this does not cover 'obligations' imposed by the Code of Conduct. Accordingly, we are concerned that firms are being put at risk of challenge of breach of the duties they owe to their clients.

We understand that the Commission has a legitimate concern in identifying cases of market misconduct. Accordingly, we could understand the Commission wanting to impose an obligation on firms to report transactions constituting market misconduct which are effected through a firm – this sort of reporting obligation has been imposed on firms in the EU under the Market Abuse Directive. However, the Commission's proposals go far beyond this and require, for instance, reports of breaches of foreign exchange/clearing house rules that apply to clients. We are not sure what regulatory interest the Commission has in relation to such information or what it would seek to do with that information – it may not be able to take any direct regulatory action itself and the constraints of s.378, SFO may not allow it to pass the information on.

We note that the Commission's comparative note on the UK, Australia and Singapore shows that those regulators focus on reporting instances of market abuse by clients (UK and Australia) and money laundering (Singapore). In other words, those jurisdictions do not impose an equivalent to what the Commission is proposing for Hong Kong. The Commission should explain what is special about Hong Kong that justifies such a wide obligation that does not appear to be imposed in these other leading markets.

We are also concerned by the overlap between what the Commission regards as being reportable to it and what is reportable to the JFIU under Hong Kong's anti-money

laundering, etc. laws, which can require reporting in relation to market misconduct under Part XIV of the SFO. In particular, we had understood that the JFIU was of the view that where reports were required to be made to it, reports should only be made to it. The JFIU should then be told that the matter would be of concern to the Commission, in which case the JFIU would then pass the information on to you.

We would welcome clarity from both the Commission and the JFIU on the correct reporting protocol.

The Commission says that firms should not encounter 'significant difficulties in complying with the proposed additional reporting requirement' because they should already have 'internal policies and procedures in place to identify possible suspicious activities'. Firms do have processes in place to spot money laundering and to guard against being used by others to effect market misconduct. But again, the scope of the proposed reporting obligation under paragraph 12.5 goes far beyond this and we doubt that firms have Hong Kong processes in place to spot, say, breaches of foreign regulations, exchange rules, etc.

In addition, we note that firms will want to commit significant time and energy to ensuring that they do not report to the Commission behaviour that is in fact legitimate, in order to avoid potentially damaging its client relationship. The cost of this should be taken into account. While it may be outweighed by the benefits of reporting, say, market misconduct, we wonder whether that is the case for reporting other matters.
In summary, we would ask the Commission to re-consider this proposal.

Question 10
Do you agree with this proposal requiring firms not to prohibit their employees from performing expert witness services?

Law Society's response:

We understand that the Commission needs to be able to access expert witnesses from time to time. However, we would point out that firms have a legitimate interest in ensuring that their employees devote the required time and attention to the jobs and roles for which they are employed – being an expert witness (whether for the Commission or anyone else) should not interfere with this. Accordingly, we would only agree with the Commission's proposal if there were an appropriate carve-out recognising this.

We note that the Commission's comparative review of the UK, Australia and Singapore shows that they have no equivalent rule. (Note: With respect to the latter, we do not understand the Commission's reference to skilled persons' reports under s.166 of the UK Financial Services and Markets Act 2000. This is about a firm having to appoint a person to investigate and report to the FSA on various matters about the firm. It is not to do with firms allowing or not allowing their employees to be expert-witnesses for the FSA.)