

**IFPHK's Response to the Consultation Paper
Commission 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**

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IFPHK Profile

Background

IFPHK was established in June 2000 as a non-profit organization for the fast-growing financial industry. It aims to be recognized in the region as the premier professional body representing financial planners that uphold the highest standards to benefit the public.

The Institute is the sole licensing body in Hong Kong authorized by Financial Planning Standards Board Limited to grant the much-coveted and internationally-recognized CFP^{CM} certification and AFPTM certification¹ to qualified financial planning professionals in Hong Kong and Macau.

It represents more than 10,000 financial planning practitioners in Hong Kong from such diverse professional backgrounds as banking, insurance, independent financial advisory, stockbroking, accounting, and legal services.



Currently there are more than 133,000 CFP certificants in 24 countries/regions; the majority of these professionals are in the U.S., Canada, China, Australia and Japan, with more than 4,200 CFP certificants in Hong Kong.

IFPHK's interest in this consultation

The global financial crisis and the subsequent investor complaints against the sales and marketing activities of financial institutions increased awareness in the lack of affordable dispute resolution channels in Hong Kong. Notwithstanding the power of the Securities and Futures Commission (the "SFC") and the Hong Kong Monetary Authority (the "HKMA") to investigate complaints and take disciplinary action against intermediaries pursuant to section 196 of the Securities and Futures Ordinance ("SFO"), consumers cannot directly seek redress or direct compensation from the regulators. On 9 February 2010, the Government launched a public consultation on the proposed establishment of an Investor Education Council and a Financial Dispute Resolution Centre ("FDRC") in Hong Kong. IFPHK has provided its response to the Consultation Paper that confirmed the need to improve the existing financial dispute resolution mechanisms available to Hong Kong consumers. The hope is this will enable them to receive a more efficient and less time consuming recourse to any unfavorable consumer experience. The Government published the results of the Consultation Paper in March 2011 and confirmed its intention to have the FDRC up and running by mid-2012.

According to IFPHK's Financial Planner Competency Survey Report, most of its members work in banks or as Independent Financial Advisors². Under the existing proposals all financial institutions regulated or licensed by the HKMA and the SFC are required to join the scheme administered by the FDRC. The establishment of an FDRC will have an enormous impact on the financial planning industry and its clients. In order to continue serving the financial planning community, IFPHK has taken a strong interest in expressing its views on the proposed changes as stipulated in this Consultation Paper.

IFPHK's representation

¹ CFP^{CM}, CERTIFIED FINANCIAL PLANNER^{CM},  CFP^{CM}, AFPTM, ASSOCIATE FINANCIAL PLANNERTM and  AFPTM are certification marks and/or trademarks owned outside the U.S. by Financial Planning Standards Board Ltd. The Institute of Financial Planners of Hong Kong is the marks licensing authority for the CFP marks and AFP marks in Hong Kong and Macau, through agreement with FPSB.

² Financial Planner Competency Survey Report 2011 edition found that IFPHK's members are working in the banking and IFA industry accounted to 40% and 10% of the CFP professionals respectively.

IFPHK was founded by 30 members ('Founding Members') in order to raise the standards of financial planners and highlight the importance of sound financial planning.

IFPHK currently has 69 Corporate Members including banks, independent financial advisors, insurance companies, and securities brokerages. With our Corporate Members providing a full spectrum of the client services and products, IFPHK is well positioned to understand the needs, concerns and aspirations of the financial planning community.

Executive Summary

The Securities and Futures Commission (the “SFC”) issued the 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 (the “Consultation Paper”) in November 2011. It then invited comments from market participants and the public on the relevant proposals set out in the Consultation Paper. The Consultation Paper explains the SFC’s proposals to amend the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the “Code”) in order to facilitate the establishment of the Financial Dispute Resolution Centre Ltd (“FDRC”) in mid-2012 and to enhance the regulatory framework.

The advantages of Alternative Dispute Resolution (“ADR”) are increasingly recognized by the global community. Growth in the use and popularity of ADR as a means of resolving commercial disputes is a tribute to a growing recognition that it provides a flexible and effective alternative to costly and time-consuming litigation. Mediation³ and arbitration⁴ are not uncommon in Hong Kong especially in the construction industry. In response to the Lehman Brothers Minibond Saga, the Government has increasingly employed ADR mechanisms to address consumers’ complaints. The Hong Kong Monetary Authority (the “HKMA”) facilitated the establishment of a Lehman-Brothers related Investment Products Dispute Mediation Scheme (the “Scheme”). Under the Scheme mediation and arbitration services were provided to aggrieved investors seeking financial redress from the bank. For unsuccessful mediations, parties had the option of proceeding to binding arbitration conducted by the Hong Kong International Arbitration Council. Consistent with the existing practice, the proposed FDRC will apply a similar model of “mediation first, arbitration next”.

In considering the proposed changes in the Consultation Paper, IFPHK supports the SFC decision to amend the Code to assist in the establishment of the FDRC. IFPHK has no major objection to the following proposals:

- Inform clients of their right to make a complaint to the FDRC if the complaint cannot be resolved internally within the firm.
- Extend telephone record keeping requirements from three to six months.
- Maintain IP address records
- Require written client authorization on order instructions by third party
- Require firms not to prohibit their employees from performing expert witness service.

Notwithstanding our support for the above, IFPHK is concerned about some of the proposals. IFPHK considers that these requirements when executed might be costly and onerous to the industry. The requirements that need further consultation include:

- Consider the subject matter of complaints from clients and take steps to investigate and remedy these issues.
- Notify the SFC upon receipt of a complaint by the FDRC.
- Licensed or registered persons should make full and frank disclosure before mediators and/or arbitrators.

³ Mediation is a process of settling disputes through discussion sessions between involved parties under the presence of a neutral third party. Mediators are not given any power to impose a settlement for the disputes. Instead, they act as a shuttle diplomat by encouraging the disputing parties to discuss, and helping them filter out their emotional elements. (from Trade and Development Council website)

⁴ Hong Kong International Arbitration Centre was established in 1985. Arbitration is a legal process through which awards are issued to the disputing parties by arbitrators rather than the court. The Hong Kong Arbitration Ordinance is widely recognized as one of the most advanced arbitration statutes in the world. (from Trade and Development Council website)

- Prohibit the use of mobile phones for receiving client orders
- Report to the SFC any suspicious activities by clients.

Considering the potential impact of the new requirements on the industry, IFPHK suggests the SFC consider the following:

- Establish collaboration mechanism and communication protocol with the FDRC and other government authorities so that recurring or systemic problems can be identified and dealt with immediately.
- Clearly define and limit the scope of the new requirements and obligations in order to alleviate the negative impact on the industry.

The statements given in IFPHK's response to the Consultation Paper are based on an objective and independent analysis of market and consumer needs. To ensure that IFPHK understands the concerns and practicality of the issue, it sought comments from active industry practitioners who deal with this issue on a regular basis.

The SFC Consultation

To prepare for the establishment of the Financial Dispute Resolution Centre (“FDRC”) in mid-2012, the Securities and Futures Commission (the “SFC”) issued a “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 (the “FDRC”) and the enhancement of the regulatory framework” (“Consultation Paper”) in November 2011.

The Consultation Paper offers proposals to amend the Code of Conduct for Persons Licensed by or Registered with the SFC (the “Code”) to set out the SFC’s expectation of licensed and registered persons in connection with the Financial Dispute Resolution Centre Ltd. One key proposal will require licensed or registered persons regulated by the SFC or the Hong Kong Monetary (the “HKMA”) to comply with the FDRC Scheme (“FDRS”) and be bound by its process. Other proposals include provisions to oblige licensed or registered persons to enhance the complaint handling procedure and act in good faith under the FDRC.

In addition, the public is being consulted on other proposed amendments, which aim to strengthen enforcement against market misconduct and to improve supervisory oversight of financial markets. These include:

- *Recording of client orders*: upgrading the order recording requirement so that telephone recording of client orders would be more readily available for dispute resolution and investigatory purposes.
- *Reporting of suspicious activities*: extending the existing reporting obligations so that licensed or registered persons would have to report to the SFC any suspicious activities by their clients.
- *Providing expert evidence*: preventing licensed or registered persons from discouraging their employees from performing expert witness services for the SFC and HKMA.

The Consultation Paper contains two parts with 10 questions relating to the aforementioned proposals on the Professional Investor Rule on which market participants and the public can comment.

Part II – Proposed establishment of the FDRC

Part III – Proposed miscellaneous amendments to the Code

IFPHK Response Methodology

IFPHK is a professional body that seeks to promote higher professional standards in the financial planning industry. It feels that it is important to respond to consultation and policy papers that significantly impact on the financial planning sector. When formulating its response to such papers it takes a systematic approach that includes:

1. An independent and objective study of the proposals and their overall impact, both positive and negative on the industry and consumers, based on theoretical and practical analysis.
2. Study of international practices of markets that are either more developed or similar to Hong Kong's in order to understand how similar proposals may have succeeded or failed and the reasons why that happened.
3. Collection of comments and opinions from industry participants including legal and compliance professionals whose business practices may be impacted by the proposals in the Consultation Paper.

After collecting and consolidating industry views, IFPHK analyzed the information obtained together with its own research in markets deemed relevant to the situation in Hong Kong such as Australia, the United Kingdom and Singapore. IFPHK formulated its responses to the various questions raised in the Consultation Paper as well as the recommendations on the practical application and effectiveness of the relevant proposals after taking into account the likely impact on the industry.

The views expressed in this submission paper are not necessarily summaries of the views taken from the industry, but may have undergone more independent and critical analysis and consideration by IFPHK as a professional body. As a result, not all the views collected by IFPHK are recorded in this submission paper and neither have all the views expressed in this submission paper been directly endorsed by those industry representatives or members consulted.

IFPHK's Submission

The submission below is the result of IFPHK seeking views from its Members in addition to its own independent internal analysis. IFPHK considers the practical implication of the proposed changes on the business of those financial planners who consider advising and providing professional services to investors as its top most priority.

Questions raised in the Consultation Paper

Part II – Proposed establishment of the FDRC

The SFC seeks views on amendments to the Code following the proposed establishment of the FDRC and the decision to use the Code as the means for obliging licensed and registered persons regulated by the SFC and the HKMA to engage in the FDRC process.

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?

The primary regulatory objective remains that licensed and registered persons should seek to resolve complaints internally. If the complaints cannot be resolved satisfactorily through internal resolution processes, eligible clients may choose to refer their complaints to the FDRC. If a complaint or dispute fails to be resolved internally, a licensed or registered person should inform clients of the right to make a complaint to the FDRC.

IFPHK's Response

IFPHK endorses the proposal of requiring firms to inform their clients of their right to take a complaint to the FDRC. At present licensed and registered persons are required under paragraph 12.3 of the Code to advise clients of "any further steps, which may be available to the client under the regulatory system". Thus the new requirement is just an extension to the current practice.

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, the firm 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?

SFC considers that licensed or registered persons should carefully consider the subject matter of complaints from clients. If the subject matter of the complaints relate to other clients or broader issues than merely those which affect the complainant, licensed or registered persons should take steps to investigate and remedy these issues, notwithstanding that other clients may not have filed complaints with the licensed or registered persons and/or the FDRC.

IFPHK's Response

IFPHK agrees that licensed and registered persons should follow the principle of acting in the best interest of clients and that a positive complaint handling culture is an effective management tool in achieving higher service standards. IFPHK also believes that an essential part of a comprehensive complaint handling system is having a procedure in place to investigate and analyze the root causes of a complaint. However,

IFPHK disagrees with the proposed changes to the Code in that the proposed requirements are different to and comparatively more stringent than the requirements in other jurisdictions. For example:

Countries	Requirements in the corresponding jurisdictions
United Kingdom	<p>The FSA Handbook on Dispute Resolution: Complaints (“DISP Handbook”) contains rules and guidance on how firms and licensees should deal with complaints from consumers.</p> <p>As stipulated in the DISP Handbook it is a rule that a respondent must put in place appropriate management controls and take reasonable steps to ensure that in handling complaints it identifies and remedies any recurring or systemic problems. However, it is only a Guidance (not a rule) that where a firm identifies (from its complaints or otherwise) recurring or systemic problems in its provision of, or failure to provide, a financial service, it should consider whether it ought to act with regard to the position of customers who may have suffered detriment from, or been potentially disadvantaged by, such problems but who have not complained and, if so, take appropriate and proportionate measures to ensure that those customers are given appropriate redress or a proper opportunity to obtain it.</p> <p>The spirit of the rules and the guidance are that firms should identify from the complaints they received any recurring or systematic issues, and then a procedure should be in place within the firm to consider whether any reasonable actions should be taken to rectify the recurring or systematic issues.</p>
Australia	<p>An EDR scheme⁵ is required to identify systemic issues and cases of serious misconduct that arise from the consideration of the complaints, and to report any systemic, persistent or deliberate conduct to the ASIC. The rule only requires the EDR (not the intermediaries) to identify and report any systemic issues to ASIC. The type of conduct or issues that might be reported is classified into 2 board categories: systemic issues and serious misconduct.</p> <p>As mentioned in above paragraph, it is the EDR scheme rather than the intermediaries that report to the ASIC any systemic issues and serious misconduct. The EDR scheme takes up part of the responsibilities in identifying and reporting systemic issues.</p>
Singapore	<p>The requirements in Singapore are similar to those of Australia in that the FIDReC (again not the intermediaries) is required to notify the MAS of information relating to systemic issues and market misconduct. Where the intermediaries receive a significant number of complaints about a specific issue or investment product, it should conduct an investigation to identify the cause of the problem and to rectify the issue immediately.</p> <p>Again, the FIDReC plays a key role in identifying and reporting systemic issues and market misconduct to the MAS. Firms are only required to investigate and rectify recurring or systemic problems that are found based</p>

⁵ Two ASIC-approved external dispute resolution schemes currently operate in the Australian financial and credit industries. Both have been approved by ASIC under the Corporations Act and the National Consumer Credit Protection Act. These schemes are Financial Ombudsman Service Limited and Credit Ombudsman Service Limited. (from ASIC website)

on a group of similar complaints.

As noted in the above table, the ADR agency in other jurisdictions has taken up part of the responsibilities of identifying and reporting systemic issues to the regulators, whereas the proposed requirements stipulated in the Consultation Paper impose heavy duties on licensed and registered persons. Moreover, most jurisdictions only require licensed and registered persons to identify recurring or systemic problems based on similar complaints (instead of on every complaint) they received from their clients.

The new requirements appear to be too broad and obscure. Such requirements will be subjected to different interpretations when implemented, thus making their impact more extensive, stringent and burdensome to the industry. IFPHK suggests the following for SFC consideration:

- *Establish communication and reporting protocol between FDRC and the relevant regulators*
As stated in the paper for Legco's Finance Committee, the guiding principle in their interface between FDRC and regulators is not to burden financial institutions with excessive requirements whilst not compromising regulators' powers and duties to investigate alleged regulatory breaches. Hence, it is decided that a memorandum of understanding ("MoU") shall be established between the FDRC and the regulators to explain clearly the delineation of respective roles and duties. IFPHK understands it is important that the SFC be made aware of any systemic market weaknesses so it can respond quickly to them. As FDRC collects complaints from different institutions it has a frontline and holistic view that could help the SFC to identify systemic issues. Therefore, it is vital to include in the MoU a formal and regular communication and reporting protocol between the FDRC and other regulators.
- *Refine the proposed requirements to provide clearer scope to the industry*
IFPHK urges the SFC to consider fine tuning the proposed requirements such that licensed or registered persons are required to take into account all relevant factors in assessing a complaint. These factors include similarities with other complaints received by the licensed or registered persons. Where licensed or registered persons identify any recurring or systemic problems from the complaints they should conduct an investigation to identify the root cause of the problem and rectify it accordingly.

Despite IFPHK reservations on the proposals, we would like to emphasize that we recognize the importance of a proper and correct complaint handling procedure. IFPHK will encourage our members to adopt best practice in their complaint handling system. IFPHK believes that the spirit of the requirements should be along the lines of encouraging intermediaries to treat each complaint as an opportunity to reflect and improve their services in a positive way. If recurring or systemic weaknesses are identified, intermediaries should take reasonable steps to address them.

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***

The proposed FDRC will pass information to the regulators to assist them in performing their regulatory functions. Some of the information that will be passed from the FDRC to the regulators will be on an anonymous basis. The inclusion of express reporting in the Code will provide a means for the SFC to be properly apprised of matters that are before the FDRC and will serve as a check on information the SFC

may receive from the FDRC. It is proposed that the Code be amended to require licensed or registered persons:

- To notify the SFC upon receipt of a complaint to the FDRC
- To provide the SFC with all documentation and information in connection with the FDRC process, if so requested by the SFC
- To provide the SFC with details of the outcome of a complaint including detailed terms of settlement, if any.

IFPHK's Response

It is decided that the FDRC would not have the investigation or disciplinary powers of the regulators. The regulators deal with regulatory breaches while FDRC deals with monetary disputes. The Intake Officers of FDRC will explain to the consumer the options they have. Ultimately it would be the consumer's decision whether to refer their case to the regulators to follow up on the alleged misconduct. Hence, IFPHK understands that the SFC is eager to stay ahead of the curve in identifying systemic market weaknesses. Whilst licensed and registered persons have a general responsibility to notify the SFC of any material events including breaches and misconduct, the proposed requirement places a heavy reporting burden on the licensed and registered persons. IFPHK considers that the onus should be on the FDRC and the regulators to agree mutually on the communication protocol for the exchange and disclosure of information that has already been submitted to the FDRC.

In Australia and Singapore, the reporting of complaint information is between the ADR agency and the regulators⁶. Moreover, ADR agencies such as FIDReC in Singapore have full power and absolute discretion where necessary to disclose information relating to a complaint, dispute or award to the regulators and the Courts. Regulators in other jurisdictions are only required to report complaints at regular intervals (from quarterly to semi-annually) instead of every time a complaint is made. For instance, ASIC and MAS require quarterly reporting from the EDR and FIDReC respectively. In the UK a firm must provide the FSA with a complete report concerning complaints received from eligible complainants twice a year.

In view of the above, the notification obligations that require licensed and registered persons to report to the SFC every complaint submitted to the FDRC along with all documents relating to the complaints are considered to be onerous on the industry. IFPHK suggests the following modifications:

- *Establish communication protocol and regular reporting mechanism with FDRC*
The interfaces between FDRC and regulators are not to burden financial institutions with excessive requirements and a MoU will be established between the FDRC and the regulators. In addition to identification of systemic issues, IFPHK suggests the inclusion of a regular reporting requirement of complaint information from FDRC to the relevant regulators. FDRC should be given absolute power and discretion to disclose and exchange all information relating to the complaint to the regulators and the Court.
- *Report complaints statistic in a standard format on a regular basis*
Instead of providing complaint information for every complaint it submits to the FDRC, IFPHK suggests adjusting the requirements so that the licensed or registered person will submit complaint statistics at a regular interval i.e. annually in a standard format such as that used in other jurisdictions.

⁶ In Australia, an EDR scheme is required to provide the ASIC with updated complaints information on quarterly basis. In Singapore, the FIDReC is required to submit to the MAS a report of all disputes received on a quarterly basis.

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?

It is considered that the licensed or registered persons should make full and frank disclosure before mediators and/or arbitrators, or whichever is applicable. They should also render all reasonable assistance to the FDRC process. This is to ensure that mediators and/or arbitrators are provided with all necessary information when considering a determination or an award.

IFPHK's Response

As the Government is pursuing a quick and non-legislative route to establishing the FDRC, IFPHK wishes to emphasize its belief that the FDRC should (1) take up the role of assisting the regulators in identifying recurring problems and systemic weakness and (2) provide regular reporting to relevant regulators. As such it is critical that the FDRC is provided with all necessary information. However, IFPHK regards the requirement to "make full and frank disclosure before mediators and/or arbitrators in connection with the FDRS" too subjective and ambiguous, which again might leave it open to different interpretations. It is uncertain what constitutes a full and frank disclosure. As such, IFPHK suggests the SFC to rephrase the requirement so that licensed and registered person provide all relevant and available information to mediators and/or in connection with the FDRS.

Part III – Proposed miscellaneous amendments to the Code

The SFC seeks public views on a number of miscellaneous amendments to the code. These proposals are part of the SFC's effort to improve supervisory oversight of the financial market and strengthen effective enforcement against market misconduct with a view to enhancing investor protection.

Question 5:

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

After a decade following the implementation of the telephone record keeping procedure the SFC considers there is a need to review the minimum retention period to ensure the requirement keeps pace with market developments. The 3 month retention period fails to meet the realistic timeline of many complaints. As such the SFC proposes to extend the minimum retention period from 3 months to 6 months. The SFC does not expect the additional compliance costs incurred by the industry to be excessive, and that the costs are outweighed by the regulatory benefits of the proposal.

IFPHK's Response

With the advancement in technology IFPHK does not anticipate that changes in record keeping requirements will add significant costs to the industry. Therefore, IFPHK does not oppose the proposal of extending the record keeping requirements from three months to six months.

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?)

The SFC would like to seek views on a proposal to amend paragraph 3.9 of the Code to prohibit the use of mobile telephones for receiving client orders. At present, the use of mobile telephones for receiving client orders is exempted from the telephone recording requirements, provided that the order details and time of receipt are properly recorded. Recognizing that the existence of the mobile telephone exemption could facilitate the risk of circumvention and undermine the telephone recording obligation, the SFC proposes to ban the acceptance of client orders through mobile phones. Although the proposed prohibition on the use of mobile telephones in receiving client orders will represent a significant change to some firms' current practice, the SFC considers that the proposed amendments will close an important avenue for individuals to sidestep the telephone recording requirements. Since the integrity of telephone recording requirements is vital to dispute resolution between the intermediaries and their clients and also to the SFC's enforcement work in deterring and tackling market misconduct, the proposed banning of using mobile phone for order taking is thus necessary.

IFPHK's Response

As part of the internal control system many firms have already discouraged their staff from using mobile phones when taking a client's order. If mobile phone conversation is inevitable, proper control measures should be in place to record the conversation. Though IFPHK has no objection to the principle of the proposals, IFPHK is uncomfortable with a complete ban on using mobile phones because their use may still be a viable alternative in some extreme scenarios, such as business continuity planning. IFPHK suggests the SFC fine tune the proposed requirements to provide some flexibility to the industry in using mobile phones in exceptional circumstances. Firms should implement adequate controls on any use of mobile phones for order taking. For instance, they should subject to the firms' internal policy and procedures to approval by the management.

Question 7:

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

Following the advancement of internet technology online trading has become a service commonly offered by intermediaries, and is well received by the market. Whilst the existing record keeping requirements provide the SFC with information on the particulars of the transaction, it lacks the substantive evidential material to establish the true identity of the person who originates the instruction for a transaction over the internet. To this end, the SFC proposes to require licensed and registered persons to retain IP address records of clients for all online transactions for a minimum period of 6 months. The aim of the proposal is to enhance the tools available to investigate market misconduct where the Internet is used as a medium for client order delivery.

IFPHK's Response

The cost of recording IP addresses might not be significant and many firms already store such information for other purposes e.g. system maintenance and marketing. However, without the assistance of third party service providers the IP address records do not provide valuable and useful information to the firms when authenticating the true identity of a client. Whilst IFPHK has no objection to the proposals, the requirement should only be limited to capture and retain the IP address records. If any further requirements on

compliance monitoring of IP address records could have an impact on the industry, IFPHK might reconsider its position on this proposal.

Question 8:

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

The SFC proposes to amend 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. At present, the Code is silent on the form of the designation required for third party authorization. Thus, the proposal is to add clarity to the requirement.

IFPHK's Response

It is reasonable to require licensed and registered persons to accept orders by a third party for a client's account only with a written authorization by the client. Although it might not be convenient for the clients and for the frontline staff, such measure will protect firms by ensuring that every transaction is backed by a genuine client authorization. Hence, IFPHK agrees with the proposed amendments to paragraph 7.1 of the Code.

Question 9:

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

At present, paragraph 12.5 of the Code requires licensed and registered persons to report to the SFC any actual or suspected material breach, infringement or non-compliance with applicable law, rules, regulations and codes by themselves or their employees. The SFC proposes in the Consultation Paper to extend the application of this reporting duty to any actual or suspected material breach, infringement or non-compliance (where applicable) committed by clients of licensed and registered persons.

SFC is of the view that the maintenance of the integrity of the market requires the coordination of licensed and registered persons, and that there are situations where intermediaries and their front-line staff are in the best position to detect irregularities of their client, given that they have day-to-day contact with the clients. The proposed requirement would protect firms from a client's potentially improper activities, if any. It will also assist the SFC in responding to suspicious market activities thereby strengthening the SFC objective to effectively supervise, monitor and regulate the conduct of market participants.

In this respect, firms should already have a set of internal policies and procedures in place to identify possible suspicious activities and ensure they are reported to the relevant authorities.

IFPHK's Response

IFPHK agrees that licensed and registered persons should have the responsibility to report promptly any suspicious activities. Nevertheless, the proposed reporting requirements on any material breach, infringement of or non-compliance of their clients with **any law, rules, regulations**, and codes administered or issued by the Commission, the rules of any exchange or clearing house of which it is a member or participant, and the requirements of any regulatory authority which applies to the licensed or registered persons are too **general and broad**. Such requirements will have significant implications for the industry.

IFPHK notes that requirements in other jurisdictions usually limit scope and type of suspicious client activity that requires reporting to the regulators. In the UK firms are required to notify the FSA of any transaction that might constitute market abuse, where market abuse is defined in section 118 of the Financial Services and Markets Act 2000 and in Market Abuse Directive, and consists primarily of insider dealing and market

manipulation⁷. In Australia, market participants are required to notify the ASIC if they suspect a person is trading with inside information or engaging in manipulative trading. In Singapore, firms are obliged to submit reports to the Suspicious Transaction Reporting Officer at the MAS for action. In consideration of the practice in other jurisdictions, IFPHK has the following suggestions:

- *Establish communication protocol between other government departments and regulators*
IFPHK is of the view that the maintenance of the integrity of the market requires coordination between the Government, different regulators and the licensed and registered persons. At present, the industry has already deployed a great deal of resources in preparing regulatory reports for corresponding authorities (e.g. JFIU). In view of the burden, IFPHK recommends not to place a heavy reliance on licensed and registered persons to provide multiple reports to different authorities. As repeatedly stated in this submission paper, the onus should be on the Government and the regulators to establish a communication protocol to disclose and exchange information that is relevant and important to their statutory objectives.
- *Limit the scope of reporting requirements*
Since the proposed requirement on a client's suspicious activities are too general and broad, IFPHK suggests the SFC to take note of the practice in other jurisdiction and try to limit the scope of the requirements.

Question 10:

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

The SFC proposes 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 HKMA. The SFC claimed that they have encountered cases where requests for assistance are met with resistance from licensed and registered persons who do not wish their employees to act as experts. This poses difficulties for the SFC in pursuing enforcement action. The new requirement is not to place a positive obligation on licensed and registered persons. However, any prohibition on employees performing such a role, absent a reasonable excuse, would reflect adversely on the fitness and properness of the licensed or registered person.

IFPHK's Response

The use of an expert witness is commonly used in international arbitration processes. IFPHK agrees that firms should not in anyway prohibit their staff from cooperating with regulators. Therefore IFPHK does not object to including a provision in the Code that requires firms not to prohibit their employees from performing expert witness services. However, IFPHK has doubts on the need to include such a provision. In March 2006, the SFC published a Guidance Note on Cooperation with the SFC. The Guidance Note states very clearly that licensed or registered persons need to cooperate with the SFC in its investigations. This principle has been well communicated to licensed and registered persons.

⁷ http://www.fsa.gov.uk/pages/About/What/financial_crime/market_abuse/index.shtml

Conclusion

To conclude, IFPHK supports the establishment of the FDRC to further enhance consumer protection by providing more accessible and affordable alternative dispute resolution channels. Similarly, IFPHK also agrees the Code should be amended to facilitate the establishment of the FDRC.

Nevertheless, IFPHK is unsure on a number of proposed changes stipulated in the Consultation Paper. IFPHK considers that these changes may have wider implications on the industry than their original intent. As such, IFPHK recommends the SFC refine the requirements by clearly defining the scope of the requirements and to establish a communication protocol with the FDRC in order to minimize the impact on the industry.

Regardless of the final result from the consultation, the formation of the FDRC is a positive development towards enhancing consumer protection. It serves as a catalyst for firms to improve their internal complaint handling procedure and encourages them to accept complaints with a positive attitude. As stated by Stuart Ayres the Manager of the Financial Dispute Resolution Scheme in New Zealand, "Usually complaints stem from miscommunication. Dispute resolution can really change relationships between consumers and financial service providers." IFPHK hopes that the development of an FDRC in Hong Kong will assist in preventing costly and lengthy litigation and assist disgruntled investors in seeking redress in the face of financial disputes. We hope it enhances the overall professional and service standard of the industry and leads to the creation of a win-win environment for both the consumer and the industry.