

ClientAlert

Hong Kong Regulatory

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Hong Kong-regulated Entities Required to Participate in the Financial Dispute Resolution Scheme; Changes to the Code of Conduct Will Require Regulated Entities to Report Suspected Market Misconduct or Offenses by Clients

Hong Kong's Securities and Futures Commission (**the Commission**) has revised the Code of Conduct once more. The Code of Conduct applies to persons licensed by or registered with the Commission.

This batch of amendments covers a wide variety of areas, some of which have been the subject of controversy during the consultation process.

As of June 19, 2012, entities licensed by or registered with the Commission (other than credit rating agencies) have been required to participate in the dispute settlement process administered by the Financial Dispute Resolution Centre Limited. The Hong Kong Monetary Authority (**the HKMA**) has imposed a similar requirement on Hong Kong-licensed banks and registered deposit-taking companies.

From December 1, 2012, a number of new obligations will be imposed by the Commission in areas such as the retention of telephone recordings, the use of cell phones for client orders, accepting orders placed for client accounts by other parties (including client employees), permitting employees to act as expert witnesses for regulators and, perhaps most controversially, notification of suspected client misconduct.

Code Requirements for Complaint-handling and Resolution of Disputes

The Code of Conduct already requires regulated entities to investigate and respond to client complaints promptly. Where a complaint is not remedied promptly, they must advise such clients of any redress that may be available to the client under applicable regulations. Under the new provisions, where applicable, this must include informing relevant clients of their right to refer disputes to Hong Kong's Financial Dispute Resolution Centre (**the FDRC**).

The revised Code also includes an obligation to conduct a broader review or investigation where the subject matter of a particular complaint relates to other clients (even if those clients have not filed complaints) or raises issues that extend beyond the complaint under consideration.

Regulated entities other than credit rating agencies are required to comply with the dispute resolution scheme administered by the FDRC. The scheme itself has relatively limited application, covering claims of HK\$500,000 or less made by individual or sole proprietor customers of relevant firms. We have set out some further information about the dispute resolution scheme below.



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Code Requirement to Notify the Commission of Suspected Misconduct by Clients

Notwithstanding a number of objections during the consultation process, the Commission has decided to implement a requirement that regulated entities report certain activities (or suspected activities) on the part of their clients. Investors in a fund would be considered "clients" of a fund manager for this purpose.

Regulated entities will be required to inform the Commission if they reasonably suspect that a client may have committed any material breach or infringement of or may not have complied with market misconduct provisions in Part XIII or XIV of the Securities and Futures Ordinance. These include insider dealing, false trading, price rigging, market manipulation, certain disclosure of information and representation offenses and fraud or deception in transactions.

Although this requirement has been watered-down from the initial proposal, it still raises several concerns for regulated entities.

Client (or investor) confidentiality will obviously be a key concern. The Commission maintains that, notwithstanding that the Code is not law, firms may be obliged to disclose information in the public interest. This would, however, entail consideration of the competing interests, and raises the question of whether the "suspicion" contemplated by the revised Code would suffice. Firms will also need to consider the scope of current client relationship agreements.

Regulated entities will need to ensure that all staff dealing with client (or investor) matters are sufficiently aware of this obligation and consider any changes that might be needed to be made to internal procedures. Firms should note that the market misconduct provisions in question are in many cases not limited to actions in Hong Kong or in respect of Hong Kong-listed securities.

Employees Acting as Expert Witnesses for the Commission or the Hong Kong Monetary Authority

If an employee of a Hong Kong-regulated firm proposes to act as an expert witness for the Commission or the HKMA, the firm will be obliged to permit this unless there is a "reasonable excuse".

Telephone Recording Retention Requirements

The current requirement to retain recorded telephone conversations for three months will be extended to six months effective December 19, 2012.

Use of Cell Phones for Receiving Client Orders

Representatives of Hong Kong-regulated entities will be prohibited from using cell phones to take client orders whilst physically in their business premises, e.g. in the office, on the trading floor, etc. Where orders are received in other locations via cell phones, whether in writing or verbally, representatives will be required to call the orders in immediately to their firms' recorded lines.

Retention of IP Address Records

In light of various comments and objections, the Commission did not implement its proposal to require regulated entities to retain records of the Internet Protocol addresses for all online transactions by clients. It has, however, "encouraged" firms to retain IP address records whenever possible for online transactions.

Third Party Authority To Be in Writing

Hong Kong-regulated entities will be required to refuse to effect transactions on instructions from a person designated by a client unless that person is authorized by the client in writing. Written authorization will be required, for example, where an institutional or corporate client designates one or more of its employees to place orders for its account.

The Financial Dispute Resolution Regime

Who can make a claim?

Claims are able to be filed by individuals or sole proprietorships against financial services providers (except credit rating agencies) that are regulated by the Commission or the HKMA. The matter must first have been brought up with the institution concerned.

What claims are covered?

The FDRC will address monetary disputes in respect of financial services provided to claimants by regulated firms.

To be eligible, the dispute must arise out of a contract between the claimant and the firm that was entered into or arose in Hong Kong, or a firm's act or omission where acting as an agent in connection with the provision of financial services to the claimant.

Each claim is limited to HK\$500,000, although a complainant may bring more than one claim.

There are a number of exclusions. These are set out in the FDRC's Terms of Reference. For example, the FDRC will not accept claims:

- concerning the performance of financial investments
- concerning general policies or practices of financial services providers
- concerning fees charged by financial services providers
- that it judges to be frivolous or vexatious
- that have already been the subject of legal proceedings or that have been or are before the Small Claims Tribunal
- that are outside the time limit of 12 months (this runs from the later of the date the services are purchased or the date the claimant knew—or should reasonably have known—about the monetary loss).

The FDRC does not have investigative or disciplinary powers, and has indicated that it will not deal with regulatory breaches that are within the purview of the Commission or the HKMA. It remains to be seen how realistic it is for the FDRC to adjudicate a monetary claim separately from any conduct or other regulatory issues that may have given rise to it.

What does the process entail?

Disputes that fall within the FDRC's terms of reference will be submitted to mediation and, if no resolution is reached by the parties and the claimant wishes to proceed, arbitration.

Regulated firms will not be able to initiate arbitration proceedings, but will be required to submit to arbitration should a claimant decide to take an unresolved dispute to this stage.

The FDRC will maintain rosters of mediators and arbitrators.

FDRC arbitrations will be "documents-only" unless the arbitrator decides that a hearing is necessary. Arbitral awards are generally enforceable through the courts in Hong Kong and in jurisdictions that adhere to the New York Convention. There is no appeal on the merits. There is a limited right of appeal against an award on a question of law or on the grounds that there has been some serious irregularity.

Is the process confidential?

Not completely, no.

The FDRC may provide regulators with information relating to what it considers to be systemic issues or suspected serious misconduct. The FDRC will also publish data, although must mask the parties' identities.

Separately, if requested, firms will be expected to provide the Commission and/or the HKMA with determination or settlement details.

What obligations does a licensed or registered firm have?

Firms regulated by the Commission or the HKMA are required to become members of the dispute resolution scheme.

The revised Code obliges regulated firms to provide all reasonable assistance to the dispute resolution forum, and to make "honest and diligent" disclosure before mediators and/or arbitrators under the regime. This standard is unfortunately vague. The Commission's paper notes that firms will typically have access to more extensive records and resources than their clients. Its main aim is that the dispute resolution process should not be prejudiced by selective disclosure by firms.

What are the costs?

Initially, the following fees have been set:

- Filing a claim: HK\$200.
- Mediation case fees (based on a mediation of up to four-hours):
 - For claims less than HK\$100,000: HK\$1,000 for the claimant and HK\$5,000 for the regulated firm.
 - For claims of HK\$100,000 or more: HK\$2,000 for the claimant and HK\$10,000 for the regulated firm.

Hourly fees apply for mediations that extend beyond four hours.

- Arbitration case fees:
 - For a "documents-only" arbitration: HK\$5,000 for the claimant and HK\$20,000 for the regulated firm.
 - Where there is an in-person hearing, additional fees of HK\$12,500 are payable by each party.

What is the FDRC and who funds it?

The Financial Dispute Resolution Centre Limited has been established by the Hong Kong government as a company limited by guarantee. It will be funded by the government, the Commission and the HKMA for the first three years, and thereafter the burden will shift to financial institutions.

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