

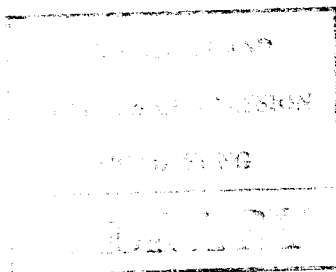
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**CONSULTATION ON THE DRAFT CODE OF CONDUCT  
FOR PERSONS REGISTERED WITH  
THE SECURITIES & FUTURES COMMISSION**

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**Securities and Futures Commission**

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November 1993

Hong Kong

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## INTRODUCTION

The Securities & Futures Commission ("Commission") has in consultation with The Stock Exchange of Hong Kong Ltd (SEHK) and Hong Kong Futures Exchange Ltd (HKFE) identified certain principles of business conduct which define generally acceptable business practices for members of these exchanges. The aim has been to establish a set of principles which are broadly comparable to those in place internationally. A new SEHK code of conduct was recently approved by the Commission and introduced by the SEHK.

Many persons registered with the Commission are not members of the Hong Kong exchanges. The Commission considers that a code of business conduct should also be developed for these registered persons. The aim again is to establish a Code which defines generally acceptable business practices broadly comparable to those in place internationally. Acceptable international practices include a set of general principles adopted by the International Organization of Securities Commissions, which represents 51 countries.

The Commission therefore proposes to prepare guidelines in the form of a Code of Conduct for the guidance of registered persons. The Commission believes the Code of Conduct will ultimately impact on whether a registered person is a fit and proper person as required under section 23 of the Securities and Futures Commission Ordinance (Cap. 24) (SFC Ordinance). The Code of Conduct will indicate the manner in which, in the absence of any particular consideration or circumstances, the Commission proposes to perform its function in administering the fit and proper test in relation to the manner in which registered persons conduct the business for which they are registered. The Code of Conduct will be published in the Gazette under section 4(2) of the SFC Ordinance.

The Code is intended to provide guidance to all persons registered under the Securities Ordinance (Cap. 333) and the Commodities Trading Ordinance (Cap. 250), including a registered dealer, dealing partnership, dealer's representative, investment adviser, commodity trading adviser, investment advisers' partnership, investment representative, and commodity trading adviser's representative.

As mentioned above, SEHK recently introduced a code of conduct for its members, which is substantially similar to this proposed Code. Further, the Commission understands that HKFE is in the process of developing a code of conduct for its members. The Commission believes that the implementation of appropriate exchange codes of conduct should provide the necessary conduct standards for exchange members and their representatives. Consequently, the Commission is considering exempting exchange members and their representatives from the Commission's Code of Conduct. However, the Commission would reserve its right to revoke such exemption if an exchange fails to maintain and enforce an acceptable code of conduct. Exchange members and their representatives are reminded that a violation of applicable exchange rules or codes of conduct must cast doubt on a person continuing to be fit and proper to remain registered.

The Code provides that it will not apply to the conduct of a registered person to the extent such person is acting in the capacity of a management company under the Commission's Code on Unit Trusts and Mutual Funds. However, the Commission intends to consider preparing further guidelines concerning such management companies, which may incorporate provisions of this draft Code.

Interested persons are invited to submit comments on the Code with the Commission by 3 December 1993. Comments should be sent to :

The Securities and Futures Commission  
12th Floor, Edinburgh Tower  
15 Queen's Road Central  
The Landmark  
Hong Kong

For the attention of the Secretary to the Commission

## **EXPLANATORY NOTES**

Where the Commission has information which suggests that a registered person is not a fit and proper person to remain registered, it may initiate an inquiry under section 56(1) of the Securities Ordinance or section 36(1) of the Commodities Trading Ordinance. This information may refer to the way in which the registered person conducts the business for which he is registered, or it may refer to other matters. The conduct of business is discussed in this document. The Commission places great importance on registered persons being fit and proper. It will review cases of registered persons not being fit and proper most stringently.

The Code does not have the force of law and should not be interpreted in a way that would override the provisions of any law.

## GENERAL PRINCIPLES

In considering whether a registered person is conducting his business satisfactorily and whether the way in which he conducts his business reflects on his ability to satisfy the fit and proper test to remain registered, the Commission will be guided by the following principles for the conduct of business. These principles have been developed and recognized by the International Organization of Securities Commissions and are fundamental to the undertaking of a registered person's business.

### 1. Honesty And Fairness

In conducting its business activities, a registered person should act honestly, fairly, and in the best interests of its clients and the integrity of the market.

### 2. Diligence

In conducting its business activities, a registered person should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market.

### 3. Capabilities

A registered person should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

### 4. Information About Clients

A registered person should seek from its clients information about their financial situation, investment experience and investment objectives relevant to the services to be provided.

### 5. Information For Clients

A registered person should make adequate disclosure of relevant material information in its dealings with its clients.

### 6. Conflicts Of Interest

A registered person should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated.

## 7. Compliance

A registered person should comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

The Commission has referred to these principles in compiling the Code of Conduct set out below.

## CODE OF CONDUCT

### C1. Interpretation and Application

- 1.1 A reference in the Code to a "registered person" has the same meaning as under section 2 of the Securities and Futures Commission Ordinance (Cap. 24). These are persons registered under the Securities Ordinance (Cap. 333) or the Commodities Trading Ordinance (Cap. 250) as a dealer, dealing partnership, dealer's representative, investment adviser, commodity trading adviser, investment advisers' partnership, investment representative, and commodity trading adviser's representative.
- 1.2 A reference in the Code to "securities" or "futures contracts" has the same meaning as under the Securities Ordinance (Cap. 333) or Commodities Trading Ordinance (Cap. 250) respectively.
- 1.3 The Code applies to all registered persons, including representatives (i.e. a dealer's representative, investment representative or commodity trading adviser's representative). However, the Commission recognizes that certain aspects of the Code may not be within the control of a representative. In considering the conduct of a representative in relation to the Code, the Commission will consider the representative's level of responsibility within the firm, any supervisory duties he may perform for the firm, and the level of control or knowledge he may have concerning any failure by his firm or persons under his supervision to follow the Code.
- 1.4 The Code shall not apply to a registered person to the extent such person is acting in the capacity of a management company in relation to an authorized unit trust or mutual fund under the Commission's Code on Unit Trusts and Mutual Funds.
- 1.5 When the Commission makes inquiry in respect of registered persons under section 56(1) of the Securities Ordinance or section 36(1) of the Commodities Trading Ordinance, the Commission will refer to matters set out in this Code in considering whether any person is or has been guilty of misconduct or is a fit and proper person to remain registered.

**C2. Honesty And Fairness**

- 2.1 Where a registered person advises or acts on behalf of a client, he shall ensure at all times that any representations made and information provided to the client are accurate and not misleading.
- 2.2 A registered person shall not (a) offer or give, or (b) solicit or accept, any inducement in relation to a client, prospective client, or any other registered person which is likely to cause the recipient to treat the giver favourably or unfairly in relation to other parties.
- 2.3 The general course of dealing or advising concerning a client, and the charges, mark ups, or fees affecting a client shall be fair and reasonable under the circumstances, and be characterized by good faith.

**C3. Diligence**

- 3.1 A registered person shall take all reasonable steps to execute promptly client orders in accordance with the instructions of clients.
- 3.2 A registered person when acting for or with clients shall always execute client orders on the best available terms.
- 3.3 A registered person shall ensure that transactions executed on behalf of clients are promptly and fairly allocated to the accounts of the clients on whose behalf the transactions were executed.
- 3.4 When providing advice to a client a registered person shall act diligently and ensure that his advice and recommendations in relation to clients are based on thorough analysis and take into account available alternatives.

#### **C4. Capabilities**

- 4.1 A registered person shall ensure at all times that any person he employs or appoints to conduct business for or with clients or other registered persons is fit and proper and otherwise qualified, including having relevant professional training or experience, to act in the capacity so employed or appointed.
- 4.2 A registered person shall ensure at all times that he has adequate resources to supervise diligently and does supervise diligently his employees and persons appointed by him to conduct business for or with clients or other registered persons.
- 4.3 A registered person shall ensure at all times that he has satisfactory internal control procedures and financial and operational capabilities which can be reasonably expected to protect his operations, his clients and other registered persons from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

#### **C5. Information About Clients**

- 5.1 A registered person shall take all reasonable steps to establish the true and full identity of each of his clients, and of each client's financial situation, investment experience, and investment objectives.
- 5.2 Having regard to information disclosed by a client and other circumstances relating to the client which the registered person is or should be aware of through the exercise of due diligence, the registered person shall, when making a recommendation or solicitation, ensure the suitability of such recommendation or solicitation for that client as is reasonable in all circumstances.
- 5.3 A registered person providing services to any client in relation to derivative products, including futures contracts or options, or any leveraged transaction shall assure himself that the client understands the nature and risks of the products and has sufficient net worth to be able to assume the risks and bear the potential losses of trading in such products.

## C6. Client Agreement

- 6.1 A registered person shall ensure that a written agreement (Client Agreement) is entered into with a client before any services are provided to that client. The registered person shall ensure that the Client Agreement is in a language understood by the client and shall explain to the client the contents of the Client Agreement.
- 6.2 A Client Agreement shall contain at least the following :
- (a) the full name and address of the client as verified by a retained copy of the identity card, relevant sections of the passport, business registration certificate, corporation documents, or any other official document which uniquely identifies the client;
  - (b) the full name and address of the registered person's business including the registered person's registration status with the Commission;
  - (c) undertakings by the registered person and the client to notify the other in the event of any material change to the information provided in the agreement;
  - (d) a description of the nature of services to be provided to or available to the client, such as securities cash account, securities margin account, discretionary account, portfolio management, investment advice, unit trusts, or futures/options account;
  - (e) a description of any remuneration (and the basis for payment) that is to be paid by the client to the registered person, such as commission, brokerage, and any other fees and charges;
  - (f) a statement indicating the circumstances under which the registered person will be acting as principal in relation to the client and that in all other circumstances the registered person will be acting as agent for the client;
  - (g) if the registered person is acting as a dealer in relation to securities, a statement explaining section 81 of the Securities Ordinance and that if the client specifically authorizes the dealer to pledge the client's securities or subject such securities to liens of third parties, the client faces a risk of loss of such securities;

- (h) if margin or short selling facilities are to be provided to the client, details of margin requirements, interest charges, margin calls, and the circumstances under which a client's positions may be closed without the client's consent;
- (i) if services are to be provided to the client in relation to derivative products, including futures contracts or options, (1) a statement that the registered person shall provide to the client upon request product specifications and any prospectus or other offering document covering such products and (2) a full explanation of margin procedures and the circumstances under which a client's positions may be closed without the client's consent; and
- (j) a risk disclosure statement as specified in the Schedule to the Code.

6.3 A registered person shall ensure that he complies with his obligations under a Client Agreement and that a Client Agreement does not operate to remove, exclude or restrict any rights of a client or obligations of the registered person under the law.

#### **C7. Discretionary Accounts**

A registered person shall not effect a transaction on behalf of a client unless before the transaction is effected (a) the client, or a person designated by the client, specifically authorized the transaction, or (b) the client has authorized in writing the registered person to effect transactions on behalf of the client without the client's specific authorization. If a registered person has obtained an authorization as described in (b) above, the Client Agreement shall specify that the account is a "discretionary account".

#### **C8. Information For Clients**

8.1 A registered person shall provide clients with adequate information about his firm including his business address, any relevant conditions or restrictions under which the registered person conducts his business, and the identity and status of employees and others acting on his behalf with whom the client may have contact.

- 8.2 Unless specifically agreed otherwise in writing by the client, after a registered person has effected a transaction for a client, he shall endeavour to confirm promptly with the client either orally or in writing the essential features of the transaction.
- 8.3 Without prejudice to the contract note provisions of the Securities Ordinance and Commodities Trading Ordinance, a registered person shall provide each client with a regular statement of account, which shall be at least quarterly, in relation to the client's transactions and related dealings and also provide such a statement on request by the client.
- 8.4 A registered person shall disclose the financial condition of his business to a client upon request by providing a copy of the most recent accounts of the business as required to be filed with the Commission under the Financial Resources Rules and disclose of any material changes which adversely affect the registered person's financial condition after the date of the accounts.

#### **C9. Client Priority**

- 9.1 A registered person shall handle orders of clients fairly and in the order in which they are received. Orders of clients or transactions to be undertaken on behalf of clients shall have in all cases priority over orders for the account of the registered person, or any account in which the registered person has an interest or the account of any employee or agent of the registered person.
- 9.2 A registered person shall, where he has aggregated an order for a client with an order for another client, or with an order for his own account, give priority to satisfying orders of clients, in any subsequent allocation if all orders cannot be filled.
- 9.3 A registered person shall not deal in any securities or futures contracts for himself or for any account in which he has an interest based upon advance knowledge he possesses of pending transactions for or with clients or on any other non-public information the disclosure of which would be expected to affect prices of such securities or futures contracts.
- 9.4 A registered person who withdraws in whole or in part from providing any investment or related services shall ensure that affected clients are promptly notified of such action and that any such business which remains outstanding is promptly completed or transferred to another registered person in accordance with any instructions of the affected clients.

**C10. Conflicts of Interest**

Where a registered person has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to such transaction, he shall neither advise, nor deal in relation to the transaction unless he has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

**C11. Client's Assets**

A registered person shall, in the handling of client transactions and assets, act to ensure that client assets are accounted for properly and promptly. Where the registered person or a third party on behalf of the registered person is in possession or control of client positions or assets, the registered person shall ensure that client positions or assets are adequately safeguarded.

**C12. Compliance**

- 12.1 A registered person shall comply with, and implement and maintain measures appropriate to ensuring compliance with the law, the rules of any exchange or clearing house of which he is a member, and the requirements of any regulatory authority which apply to the registered person.
- 12.2 A registered person shall have a policy which has been communicated to employees in writing on whether employees are permitted to deal for their own accounts in securities or futures contracts. If employees are permitted to deal, the conditions on which they may do so shall be set out in writing and communicated to each employee. A registered person shall not knowingly deal in securities or futures contracts for another registered person's employee unless he has written to that registered person and received his written consent.

12.3 A registered person shall ensure that :

- (a) complaints from clients relating to his business are handled in a timely and appropriate manner;
- (b) steps are taken to investigate and respond promptly to such complaints; and
- (c) where a complaint is not remedied promptly, the client is advised of any further steps which may be available to the client under the regulatory system.

12.4 A registered person shall at all times be responsible for the acts or omissions of his employees and agents in respect to the conduct of his business.

## SCHEDULE

A Client Agreement under provision C6 of the Code shall include the following applicable risk disclosures in print at least as large as other text in the Client Agreement.

1. If the Client Agreement involves transactions in securities a statement as follows -

### RISK DISCLOSURE STATEMENT

The price of securities can and does fluctuate, and any individual security may experience upward or downward movements, and may even become valueless. There is an inherent risk that losses may be incurred rather than profit made as a result of buying and selling securities.

2. If the Client Agreement involves transactions in futures contracts or options a statement as follows -

### RISK DISCLOSURE STATEMENT

The risk of loss in trading futures contracts or options can be substantial. In some circumstances, you may sustain losses in excess of your initial margin funds. Placing contingent orders, such as "stop-loss" or "stop-limit" orders, will not necessarily achieve the desired results. Market conditions may make it impossible to execute such orders. You may be called upon at short notice to deposit additional margin funds. If the required funds are not provided within the prescribed time, your position may be liquidated. You will remain liable for any resulting deficit in your account. You should therefore study and understand futures contracts and options before you trade and carefully consider whether such trading is suitable in the light of your own financial position and investment objectives.