

Simmons & Simmons

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Our ref INTL FIN./PL/LZC
Your ref

The Securities and Futures Commission
(Code of Conduct)
12/F Edinburgh Tower
15 Queen's Road Central
Hong Kong

Dear Sirs

Consultation on the Proposed Revisions to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission

- 1.1 We welcome the opportunity to comment on the consultation on revisions to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "Code of Conduct").
- 1.2 We note that most provisions have been carried over from the existing Code of Conduct but take this opportunity to make comments on areas where we believe improvements can be made to the clarity and scope of the provisions.
2. **General Comment**
 - 2.1 The Commission has, over the years, issued ad hoc guidelines and circulars regarding a variety of subjects, for example, the issue of advertisements by intermediaries and internet trading and advising. Please consider whether these guidelines and circulars may be incorporated into the Code of Conduct for completeness. A single Code of Conduct would be consistent with the concept of a single licence under the Securities and Futures Ordinance (the "SFO") as well as the comprehensive approach of the SFO itself. This would also assist in assuring further developments by way of guidelines issued by the Commission are consistent and conform with existing requirements.
3. **Know Your Client**
 - 3.1 Paragraph 5.1 of the Code of Conduct relates to the "know your client" rules. We welcome the revisions made in June 2002 which provide more flexibility for non face-to-face account opening procedures. However, these provisions do not fully address issues connected with account opening for overseas clients. In particular, many potential overseas clients do not have a bank account in Hong Kong. We note the importance of verifying the true identity of

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the client and concerns about money laundering, however, given that Hong Kong is an important international financial centre (and wishes to become more so), it seems inappropriate to make account opening a too difficult and onerous process. Thus, we recommend accepting verifications or referrals from reputable overseas financial intermediaries (e.g. duly registered/supervised by their local regulators in jurisdictions recognised by the Commission) whether or not the overseas entity is an affiliate of the SFC registrant.

3.2 In addition, the provisions on client identity seem to refer to individuals, please clarify how they apply to corporate entities. For example, should identity cards or passports of directors/shareholders of the corporate client be provided?

3.3 Paragraph 5.4(b) requires intermediaries to keep certain information in Hong Kong and gives the Commission access to that record upon request. Under s.130 of the SFO, the Commission may approve premises to be used for keeping records or documents. We suggest that it should be made clear whether or not the Commission may accept such records being maintained overseas.

4. **Information for Clients**

4.1 An intermediary is required to confirm after it has effected a transaction for a client promptly under paragraph 8.2. Please clarify whether this requirement to make such confirmation exists independently of the requirement to provide contract notes under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules. Specifically, we suggest it should be stated that the requirement to "confirm promptly" is satisfied if the intermediary issues a contract note within the time specified in the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.

4.2 Pursuant to paragraph 8.4, an intermediary should, upon request, disclose the financial condition of its business to a client and disclose any material changes which adversely affect the intermediary's financial condition after the date of the accounts. Please clarify whether the disclosure of material adverse change only applies on request or whether there is a positive duty on the intermediary to make disclosure. If there is a positive duty to disclose, rather than merely upon request, we suggest it is clarified whether the disclosure is required to be made to the Commission or to clients generally (or, of course, to both).

5. **Professional Investors**

5.1 Paragraph 15.5 relates to certain provisions which may be waived for professional investors. The need to enter into a client agreement and the need to obtain written authority from a client prior to effecting transactions is waived. Although this provides flexibility we would suggest that, to be meaningful, the scope of this waiver is extended to other requirements for documentation from professional investors. For example, intermediaries must comply with the client identity procedures regardless of whether the client is a professional investor. In addition, where the client is another intermediary, he should obtain an undertaking that the intermediary client will in turn require his underlying client to disclose the ultimate beneficiaries to the regulators. To be consistent, if a registered or licensed person is satisfied that its client is a professional investor, whatever procedures it adopts should be a matter for the registered or licensed person. Alternatively, the Code of Conduct should require a client agreement for professional investors. Without a specific agreement to bind the client, there may be uncertainty as to whether the intermediary may be in breach of the rules. Therefore, we recommend either requiring client agreements to be kept for all clients but relax the content requirements for professional investors or abolish all documentary requirements for professional investors.

6. **Schedule 1 - Risk Disclosure Statements**

- 6.1 Schedule 1 requires staff of an intermediary to make a declaration and clients to acknowledge that the risk statements have been provided in a language of the client's choice and the client has been invited to take independent advice. Given the possibility of non face-to-face account opening procedure, the terms of the declaration may not be applicable in each case. We suggest making this clear in the Code of Conduct.
- 6.2 In light of the Commission's concerns about investors' understanding of equity-linked instruments, we suggest adding a mandatory warning statement about trading in ELI's where applicable.
- 6.3 We note that paragraphs 7-13 of Schedule 1 under "Additional Risks Common to Futures and Options" may not be particular to trading in futures and options but could also apply to other investment activities. We suggest moving these paragraphs to an earlier section of the Schedule.

7. **Schedule 2 - Client Identity Guidance Notes**

- 7.1 The Client Identity Guidance Note refers to paragraph 5.4 as intended to improve the transparency of trading in securities or futures contracts listed or traded on a recognised stock market or a recognised futures market *or in derivatives, including over-the-counter derivatives, written over such securities or futures*. Our understanding is that over-the-counter derivatives over futures contracts which are not exchange traded are not caught by the Commodities Trading Ordinance. Therefore, if a person trades in over-the-counter derivatives in futures contracts, there is no requirement for this person to be licensed by the Commission. However, if this person happens to be an SFC registrant or licensee, his conduct in trading these over-the-counter derivatives would be regulated by the Commission and the identity of the ultimate beneficial owners becomes relevant. This is inconsistent. The Commission may wish to consider removing the reference to over-the-counter derivatives.

8. **Schedule 4 - Futures and Options**

- 8.1 Schedule 4 sets out additional requirements for dealing in futures and/or options traded on the Hong Kong Futures Exchange Limited. A large part of this section deals with record keeping requirements and the treatment of client monies and client assets. Although we do not see any clear conflict, there is some overlap with the Securities and Futures (Keeping of Records) Rules, Securities and Futures (Client Monies) Rules and Securities and Futures (Client Securities) Rules. To avoid confusion, we would suggest removing specific requirements from the Code of Conduct and making appropriate reference to the subsidiary legislation for greater simplicity.
- 8.2 Paragraph 1A refer to confirmations made by telephone. We suggest it is clarified whether the obligation to confirm a transaction applies independent of the requirement to issue contract notes.


9. **Schedule 6 - Leveraged Foreign Exchange Trading**

- 9.1 We note that the requirement to enter into a written client agreement under paragraph 1 of Schedule 6 has been waived in respect of professional investors. It is unclear whether paragraphs 6-10 containing requirements in respect of discretionary accounts are also waived.

- 9.2 In respect of paragraph 39 under Schedule 6, please confirm whether it is the Commission's intention to require active monitoring of tapes regardless of whether any complaints or suspicious circumstances exist. In view of the fact that confirmations must be given, unless circumstances exist where such monitoring is warranted, we do not believe that a licensed person should be obliged to carry out random checks every week to ensure compliance.

If you have any questions in respect of the above, please contact Paul Li at 2583 8269, Rolfe Hayden at 2583 8302 or Liana Cheung at 2583 8281.

Yours faithfully



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