

## TOPIC 4 - OVERVIEW

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## 1. CODE OF CONDUCT

- Full title: **Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission**
- The nine general principles of the Code of Conduct are based on the principles developed and recognised by the International Organization of Securities Commissions (IOSCO)

### 1.1 The Nine General Principles

- The Code of Conduct is based on nine general principles:
  1. Honesty and fairness
  2. Diligence
  3. Capabilities
  4. Information about clients
  5. Information for clients
  6. Conflicts of interest
  7. Compliance
  8. Client assets
  9. Responsibility of senior management

### 1.2 Effect of Breaches of the Code of Conduct

- The Code **does not have the force of law**, however it is important in two respects:
  - A **breach** can lead to a fine, reprimand, license suspension or revocation;
  - It can be referred to in court legal proceedings, thereby giving it a degree of legal recognition

## 2. MARKET INTEGRITY

### 2.1 General Principle 1 – Honesty and Fairness

- A **licensed/registered person** should act honestly, fairly and in the best interests of its clients and the integrity of the market. More specifically:
  - Representations and information to clients should be **accurate and not misleading**
  - **Charges** to clients should be **fair and reasonable**
  - **Invitations and advertisements** should not contain information that is false, misleading or deceptive; no negative advertising
  - Actions should comply with the **Prevention of Bribery Ordinance** and any related guidelines issued by the **ICAC**
- A representative acting as an agent should not solicit or receive money/gift/employment/services without permission from the principal

### 2.2 General Principle 2 – Diligence

- A **licensed/registered person** should act with due skill, care and diligence, in the best interests of its clients and the integrity of the market. Some practical examples of this are:
  - Client orders should be executed promptly in accordance with clients' instructions – **prompt execution**
  - Client orders should be executed on the best available terms – **best execution**
  - Orders executed for clients should be promptly and fairly allocated to those clients – **prompt and fair allocation**
  - Clients' orders should not be withheld for convenience
  - **Advice** should be given to clients with due skill, care and diligence
  - **Separate accounts** should be kept for each client and for securities, futures, cash and margin accounts
  - Clients must be informed of **derivative position and reporting limits**
  - All orders should be time-stamped
- **Telephone orders** should be centrally recorded. Recordings should be kept for at least **6 months**
- The use of **mobile phones** for taking client orders is **discouraged, but not banned** – time of order receipt and details should be recorded immediately
- The best interests of the clients should be considered when recommending the services of an affiliated person
- Collect promptly from clients any amount due as **margin**
- Not offer any gift other than a discount on fees or charges when promoting a specific investment product

## 2.3 General Principle 3 – Capabilities

- A **licensed/registered person** should have and employ effectively the resources and procedures which are needed for the proper performance of its business activities. It should have:
  - Staff who are fit and proper to carry out their duties
  - Adequate and diligent supervision of staff
  - Satisfactory internal control procedures, financial resources, operational systems and technology

## 2.4 General Principle 6 – Conflict of Interest

- A licensed/registered person should try to avoid conflicts of interest between:
  - One client and another client
  - A client and a licensed/registered person
- Where conflicts cannot be avoided, disclosure of the conflict should be made to the client, and all reasonable steps should be taken to ensure fair treatment of the client
- If an intermediary has a material interest in a client transaction, it should not handle the transaction unless the interest has been disclosed to the client and all reasonable steps to ensure fair treatment have been taken

### Handling of Client Orders

- Client orders should be handled **fairly and in the order** in which they are received
- Client orders should have **priority** over orders for the account of the licensed/registered person, or for the account of any employee or agent of the licensed/registered person
- Where there are aggregated orders for several clients, and the intermediary itself, priority must be given to client orders if all orders cannot be filled
- The unfair preference of any one client should be avoided
- When handling client orders, a licensed/registered person will acquire non-public information. This information should not be used to deal:
  - Ahead of transactions pending for other clients (front running)
  - When the release of the information will affect the price

### Withdrawal from Business

- A licensed or registered person ceasing to carry out a regulated activity should promptly notify clients of the fact

**Rebates, “Soft Dollars” and Connected Transactions**

- An intermediary that operates a discretionary account may receive goods or services from a broker in exchange for directing a client’s business to the broker only if:
  - the goods or services are of **demonstrable benefit** to the receiver’s client;
  - the receiver applies best execution standards to the underlying business and the brokerage charges by the giver are not in excess of the normal rates;
  - the client has consented in writing to the receipt of the goods or services; and
  - disclosure is made to the client of the intermediary’s practices relating to receiving such goods or services, including their description
- Goods and services **permitted** by the SFC are:
  - research and advisory services
  - portfolio analysis, including valuations and performance measurement
  - market analysis, data and quotation services
  - computer hardware and software incidental to the above goods and services
  - clearing and custodial services
  - investment related publications
- Goods and services **not permitted** by the SFC are:
  - travel, accommodation & entertainment
  - general administrative goods or services
  - general office equipment or premises
  - membership fees
  - employee salaries
  - direct cash payments
- An intermediary may receive and retain cash or money rebates in relation to client transactions, provided:
  - The client has consented to this in writing (with disclosure at least annually of details of the goods and services received)
  - The brokerage rates are not in excess of customary full-service rates
  - The rebates and their approximate values are disclosed to the client (must provide a quantification of the rebates received in each contract note or in semi-annual statements)
- If a client exercises his right under a cooling-off mechanism, the client should receive a full refund, including sales commission less any reasonable prior-disclosed handling charge

## 2.5 General Principle 7 – Compliance

- Licensed/registered persons should comply with all regulatory requirements including:
  - Primary and subsidiary legislation
  - Rules, regulations and codes administered/issued by the SFC
  - Rules of exchanges and clearing houses, if participants
  - Requirements of other relevant regulatory authorities
- Specific provisions of the code cover the following 6 areas:

### **Obligations under the Financial Dispute Resolution Scheme (FDRS)**

- A regulated person should fully comply with the FDRS for managing and resolving disputes administered by the Financial Dispute Resolution Centre (effective from 19 June 2012)

### **Employee Dealings**

- The licensed/registered person must have a written policy specifying whether or not employees can deal or trade for their own accounts and if they can, the policy must specify the following:
  - the conditions on which employees may deal or trade;
  - that employees should generally be required to deal through their principal or its affiliates;
  - duplicate trade confirmations should be provided to senior management if employees are permitted to deal through another dealer;
  - that employees should identify all related accounts (including amounts of their minor children and those in which the employees hold beneficial interests) and report them to senior management;
  - any such transactions should be separately identified in the intermediary's records and actively monitored by senior management (to ensure transactions are not prejudicial to client interests); and
  - no intermediary should knowingly have another intermediary's employee as a client without the written consent of the employee's principal

### **Complaints**

- Complaints should be handled in a timely and appropriate manner, investigated and responded to promptly
- If unable to investigate, licensed/registered person should advise client of further steps available

### **Responsibility for Acts of Employees**

- A licensed corporation or registered institution should be responsible for the acts/omissions of its employees and agents

**Notifications to the SFC**

- A licensed/registered person is required to make reports to the SFC immediately on discovering:
  - Material breaches or suspected material breaches of any law, regulation or code
  - Insolvency situations affecting it, substantial shareholders or directors
  - Disciplinary actions taken against it
  - Material problems with business systems/equipment
  - Suspected material breach of market misconduct provisions

**Co-operation under the FDRS**

- A licensed/registered person should make honest and diligent disclosure before mediators/arbitrators in connection with the FDRS

**2.6 Omnibus Accounts**

- An omnibus account is an account opened with an exchange participant by a client who operates the account for a customer, or a number of customers, of the client and not the client itself
- Information that should be kept for all omnibus accounts:
  - Name of client and whether it is an HKFE Participant
  - Client's address and account title
  - Whether transactions are HKFE or non-HKFE trades; and
  - Whether the client is a registered dealer authorized to operate an omnibus account
- A licensed/registered person which is an HKFE exchange participant must ensure that a client who is not an HKFE exchange participant, but operates an omnibus account should:
  - Comply with and enforce the HKFE margin and variation adjustment requirements
  - Deal with instructions so that there is no unlawful dealing in differences in market quotations and no betting
  - Ensure that the persons who give instructions to the client comply with the HKFE margin and variation adjustment requirements



### 3. CLIENTS

#### 3.1 General Principle 4 – Information about Clients

- A **licensed/registered person** should seek information about a client's financial situation, investment experience and investment objectives. Three sections to be covered:
  - Know your client (KYC)
  - Client agreements
  - Discretionary accounts

##### Know Your Client

- A **licensed/registered person** should establish a client's:
  - True and full identity
  - Financial situation or strength
  - Investment experience
  - Investment objectives
- Requirements intended to improve the transparency of trading in securities or futures contracts
- Where the **SFC requests identity information** of ultimate clients, it will consider the requirements to have been complied with if the information is provided **within 2 business days** of the request
- Before accepting an **order from a third party** in respect of a client account, reasonable steps should be taken to establish the true and full identity of the third party
- **Recommendations** made to clients should be **suitable**, given their circumstances
- When a client **without knowledge of derivatives** wishes to invest in a derivative product, the risks should be explained

##### Client Agreements

- A written client agreement should be entered into with a client before providing services to the client.
- The agreement should be in Chinese or English, at the option of the client
- Attention to relevant risks should be drawn to the client
- If a face-to-face meeting with the client does not take place, a copy of the agreement should be provided to the client, and steps should be taken to verify the client's signature

- All **client agreements** should contain:
  - **Full names and addresses of client** (verified by reliable proof) and licensed/registered person
  - Undertakings by parties to **notify material changes** of information to each other
  - **Full description of services** to be provided and charges to be paid by the client
  - **Full explanation of the margin procedures**, the circumstances under which a client's positions may be closed without the client's consent and a statement that a report may need to be made to HKFE and the SFC, if margins are not paid on time
  - A statement that the licensed person will provide the client, upon request, with **product specifications and prospectuses**
  - An explanation that, if the client suffers loss because the intermediary defaults, the **liability of the Compensation Fund** will be limited and, accordingly, there can be no assurance that any or all of the loss will necessarily be recouped
  - A statement that **trades are subject to the rules of the HKFE** including:
    - **Client's identity** will be disclosed if a request is received from the HKFE
    - **HKFE may limit positions** or close out contracts if client's trading affects the fair and orderly operation of the market
  - A statement (prominently displayed in bold type) that the intermediary may take the **opposite position to the client's order** provided that the opposing trade is executed competitively on or through the facilities of the HKFE
  - Clarification that, with regard to any account that the intermediary maintains with the clearing house as principal, any assets lodged with the clearing house for such an account are **not held in trust for the client**
  - From 9 June 2017, the Code of Conduct requires:
    - A clause stating that any financial product solicited for sale or recommended will be suitable for the client
    - No provision in the client agreement that is inconsistent with the Code of Conduct obligations
  - Appropriate risk disclosure statements
  - Client agreements should not remove, exclude or restrict the legal rights of a client or the legal obligations of the licensed/registered person

### Risk Disclosure Statements

The risk disclosure statement suggested for trading in futures and options is as follows:

*“The risk of loss in trading futures contracts or options is 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 avoid loss. 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. If you trade options you should inform yourself of exercise and expiration procedures and your rights and obligations upon exercise or expiry.”*

- Additional risk disclosures consist of:
  - Futures: effect of *leverage* or *gearing*
  - Futures: risk-reducing orders or strategies
  - Options: variable degree of risk
- Additional risks common to futures and options:
  - Terms and conditions of contracts
  - Suspension or restriction of trading and pricing relationships
  - Deposited cash and property
  - Commission and other charges
  - Transactions in other jurisdictions
  - Currency risks
  - Trading facilities
  - Electronic trading
  - Off-exchange transactions

### Non Face-to-Face Approach

- Face-to-face account opening best way to verify identity
- If not possible, the documents should be certified by an appropriate person (licensed person, JP, bank manager, accountant, lawyer, notary) or services recognised by the Electronic Transactions Ordinance (such as Hong Kong Post certification services)
- Intermediary can cash a client’s cheque (of at least HK\$10,000) to check identity and signatures to check that signature is the same on a signed client agreement

**Online Onboarding of Clients using a Hong Kong Bank A/C**

- Licensed/registered person verifies the identity of an individual client by:
  - Obtaining a client agreement, signed by the client through an electronic signature, with a copy of the client's identity document
  - Successfully receiving into its own bank account a transfer of an initial deposit of not less than HK\$10,000 from a bank account in the client's name maintained with a licensed bank in Hong Kong
  - Conducting all future deposits/withdrawals for the client's trading account through the designated bank account only

**Remote Onboarding of Overseas Individual Clients**

- Licensed/registered person verifies the identity of an individual client by:
  - Accessing the embedded data in, or obtaining an electronic copy of, the relevant sections on the client's identity document (passport/identity document) including a client photograph
  - Adopting effective and appropriate technologies to authenticate the client's identity document
  - Obtaining prior consent from the client if a third party is involved in the account opening procedures
  - Obtaining a client agreement signed by the client with an electronic signature
  - Successfully receiving into its own bank account a transfer of an initial deposit of not less than HK\$10,000 from a bank account in the client's name maintained with an overseas bank supervised by a banking regulator in an eligible jurisdiction
  - Making future deposits/withdrawals for the client's trading account only via the client's designated overseas bank account
  - Maintaining proper and readily accessible records of each client's account opening process
  - Ensuring that staff responsible for online boarding have sufficient knowledge/skills to perform the relevant procedures
  - Conducting comprehensive assessments at least annually on whether the adopted processes and technologies are appropriate and effective

### Discretionary Accounts

- A discretionary account is a client account operated by the licensed/registered person, without the client's prior approval for each transaction
  - The discretion may be absolute or subject to conditions
  - The Code of Conduct imposes the following on the establishment and operation of discretionary accounts:
    - The client's authority should be in writing
    - The person authorized to operate the account should be identified
    - The terms of the authority should be explained to the client
    - The authority should be confirmed annually
    - The account should be designated as a discretionary account and be approved by senior management
    - The licensed/registered person must disclose to the client, in writing, any benefits that it receives in relation to the client's transaction, including monetary and non-monetary benefits
    - Internal control systems should ensure that the operation of the account is properly supervised
  - **Additional requirements for HKFE exchange participants** who want to trade futures and options via a discretionary account:
    - Intermediary is required to notify the client if the **net equity**\* falls by more than 50% or falls below a sum specified in writing by the client, in any period of three days or less
    - **No new trades** may be initiated without the prior written approval of the client, until the net equity exceeds the specified amount or is restored to the level at which it stood at the beginning of the period
    - **No more than two "day trades"** may be executed in any market, and no short options positions may be opened unless the client has given prior written approval for such transactions
- \* **Net equity** = balance shown in the discretionary account ledger + floating profits – floating losses – adjustments for levies or commission due from the client

## 3.2 Professional Investors

- Professional Investors (PIs) do not need the same degree of protection that the ordinary retail investor might require
- SFC recognizes three categories of PI:
  - **Institutional PIs:** Defined in the SFO and tend to deal as principals
  - **Corporate PIs:** Prescribed in the Securities and Futures (Professional Investor) Rules that are corporates, trusts or partnerships
  - **Individual PIs:** Prescribed in the Securities and Futures (Professional Investor) Rules who are individuals

### 3.2.1 Institutional Professional Investors

- Exchange companies
- Intermediaries and similar overseas providers, including their wholly owned subsidiaries, holding companies and wholly owned subsidiaries of the holding companies
- AFI's and similar overseas institutions
- Insurers regulated under the Insurance Ordinance and their overseas equivalents
- CISs authorized in Hong Kong and their regulated overseas counterparts
- Registered schemes as defined in the MPFO and ORSO schemes, and their approved trustees, service providers, investment managers, their administrators and regulated overseas counterparts
- Governments, central banks and multilateral agencies

### 3.2.2 Corporate Professional Investors

- trustee companies responsible for total assets of not less than HK\$40m;
- corporations or partnerships having either a portfolio of not less than HK\$8m, or total assets of not less than HK\$40m; and
- corporations that act solely as investment holding companies and are wholly owned by persons who belong to any of the above two categories
- holding companies of the above two categories

### 3.2.3 Individual Professional Investors

- high net worth individuals having a portfolio of not less than HK\$8m; [includes spouses/children where portfolios are held jointly]
- the portfolio is held by a corporation which is wholly owned by the individual

### 3.2.4 Waivers Applicable to Professional Investors

- **Non-applicable SFO provisions:**
  - Unsolicited call provisions (ie PIs can be cold-called)
  - Requirements for offers by intermediaries

Above exemptions **apply to Institutional PIs, Corporate PIs and Individual PIs**

- **Non-applicable Code of Conduct requirements:**

- a) Information for clients:**

- (i) The need to provide information about the licensed/registered person and its employees
    - (ii) The need to make prompt confirmation of transactions to clients
    - (iii) The need to disclose transaction related information
    - (iv) The need to provide documentation on the Nasdaq-Amex Pilot Programme
    - (v) The need to ensure the suitability of a complex product transaction; to provide sufficient information about a complex product; and to provide warning statement

All above exemptions **apply to Institutional PIs and Corporate PIs**

**Exemptions (a) (i), (ii) and (iv) apply to Individual PIs**

- b) Information about clients**

- (i) The need to establish the client's financial situation, investment experience and investment objectives (except advice on corporate finance)
    - (ii) The need to ensure the suitability of a recommendation or positive invitation
    - (iii) The need to assess the client's knowledge of derivatives

All above exemptions **apply to Institutional PIs and Corporate PIs**

- c) Client agreement: the need to enter into a written client agreement and provide risk disclosure statements**

The above exemption **applies to Institutional PIs and Corporate PIs**

- d) Discretionary accounts**

- (i) The need to obtain the client's prior authority in writing before effecting transactions
    - (ii) The need to explain the written authority and confirm it annually (authority should still be obtained)
    - (iii) The need to disclose benefits receivable for effecting transactions for a client under a discretionary account

All above exemptions **apply to Institutional PIs and Corporate PIs**

### Institutional PIs

- Licensed and registered persons are automatically exempted from the above listed requirements

### Corporate PIs and Individual PIs

- To apply the exemptions, the licensed or registered person must:
  - write to the client explaining the consequences/risks of being treated as a PI, the information that he will not receive and that he has the right to withdraw from being treated as a PI
  - obtain a written and signed declaration from the person that he has been provided with the above explanations and that he wished to be treated as a PI
  - carry out confirmation exercise annually
- When the above is complied with the licensed/registered person is exempt from complying with **(a) (i), (ii) and (iv)**

### Corporate PIs only

- If the licensed/registered person is satisfied that the corporate PI:
  - Has an appropriate corporate structure
  - Has appropriate investment processes and controls
  - Has investment decision makers with sufficient investment background and experience
  - Is aware of the risks involved in terms of the person(s) making the investment decisions

**THEN the Corporate PI is exempt** from all Code of Conduct requirements listed above

## 3.3 General Principle 5 – Information for Clients

- The SFC expects a licensed or registered person to provide information to its clients in order to maintain transparency, as well as to let them know about their transactions. Information about the registered person includes:
  - Information about its business, including contact details, services provided, and identity/status of employees with whom the client will have contact
  - In the case of a financial services group, clear information about the particular company the client is dealing with
  - Upon client request, audited financial statements and information on corporate actions
- The Code of Conduct requires pre-sale disclosure to a client, other than a PI, to include:
  - whether the intermediary is acting a principal or agent and any affiliation of the intermediary with the product issuer
  - any explicit monetary and non-monetary benefits from a product issuer for distributing an investment product
  - the terms and conditions under which the client may receive a discount of fees and charges from the intermediary



### 3.4 General Principle 8 – Client Assets

- A licensed/registered person should ensure:
  - Client assets are promptly and properly accounted for
  - Client assets are adequately safeguarded
- Subsidiary legislation has applied the principle through the **Client Securities Rules** and the **Client Money Rules**
- Code of conduct includes specific requirements for intermediaries dealing in futures contracts on the HKFE in relation to client assets

## 4. SENIOR MANAGEMENT’S RESPONSIBILITY

### 4.1 General Principle 9 – Responsibility of Senior Management

- Senior management should bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures of the firm
- Senior management are expected to properly manage the risks associated with the business by understanding:
  - the nature of the business
  - its internal control systems and procedures
  - its risk management policies
  - the extent of their authority and responsibilities
- Senior management should have access to all information about the business on a timely basis and necessary advice on their own responsibilities
- For licensed corporations, the SFC considers the following to be **senior management**:
  - All directors, including shadow directors
  - Responsible officers
  - Any individual who is **manager-in-charge (MIC)** for one or more of the following core functions:
    - Overall management oversight\*
    - Key business line\*
    - Operational control and review
    - Risk management
    - Finance and accounting
    - Information technology
    - Compliance
    - Anti-money laundering and counter-terrorist financing

- Although MICs typically do not need to be licensed, the SFC expects those marked \* above to be licensed and approved as responsible officers
- An individual does not need to be licensed to be identified as a MIC
- An organisational chart and the name of each MIC must be provided to the SFC, suitably updated when there are subsequent changes
- Once a person has been identified as a MIC, any changes to the person's appointment must be notified to the SFC, as for licensed staff
- MICs must be fit and proper to carry out their duties and the SFC will use its discretion to determine if a MIC is fit and proper
- MICs past conduct, including compliance with SFC codes and guidelines, will be taken into account

## 4.2 Conduct Requirements of Electronic Trading

- Para 18/Schedule 7 of the Code of Conduct sets out the conduct requirements of electronic trading. **Electronic trading** refers to the trading of securities and futures contracts electronically and includes internet trading, direct market access and algorithmic trading

### 4.2.1 Responsibility for Orders

- A licensed or registered person is responsible for:
  - Settlement and financial obligations of orders made electronically
  - Supervise orders in compliance with regulatory requirements

#### Management and Supervision

- Design and operation of an electronic trading system should be effectively managed and adequately supervised, including:
  - Written internal policies and procedures
  - At least one responsible officer or executive officer responsible for overall management and supervision
  - Adequate qualified staff, technology and financial resources

#### Adequacy of System

- The following controls should be adopted to ensure the reliability, security and capacity of the system:
  - Ability to immediately **prevent the system from generating and sending orders** to the market and cancel any unexecuted orders
  - System should be **tested before deployment** and regularly reviewed
  - Any material **service interruption should be promptly reported** to the SFC

- **Security controls** should ensure that: reliable authentication or validation techniques are used restricting access as appropriate; confidential information is protected; and security breaches are prevented and detected
- Monitoring of system capacity usage and recording of spare capacity planned
- Stress testing of system capacity and documentation of findings
- Ability to handle client orders beyond system capacity

#### **Record Keeping**

- Records should be kept covering:
  - Design and development of electronic trading system
  - Comprehensive documentation of risk management controls of the system (should be kept for 2 years after ceasing to use the system)
  - Audit logs of system delays/failures (to be kept for 2 years)
- Recommendations made should be suitable for the client in light of client's financial situation, investment objectives and experience

### **4.2.2 Specific Requirements on Internet Trading and Direct Market Access (DMA)**

- DMA refers to the access to a market provided to a client through a licensed or registered person's identifier under which the client transmits orders, directly or indirectly, to the market's trade matching system for execution

#### **Risk Management**

- A licensed/registered person providing internet trading/DMA must ensure that all client orders are transmitted to its infrastructure.
- Controls should prevent entries that exceed trading or credit limits
- Controls should prevent erroneous order entries
- Regular post-trade monitoring should identify manipulative or abusive order instructions/transactions

#### **Minimum Client Requirements for DMA Services**

- Each client should meet requirements before being granted the DMA service. The requirements are that the client:
  - ensures users are proficient and competent in using the system
  - understands and complies with applicable regulatory requirements
  - can monitor orders entered through the system

### 4.2.3 Algorithmic Trading System and Trading Algorithms

- An **algorithmic trading system** is a system through which algorithmic trading (ie computer generated trading activities created by a predetermined set of rules aimed at delivering specific execution outcomes) is conducted. It includes a system designed and developed in-house or by a third-party service provider

#### Qualification

- Suitably qualified persons should be involved in the design and development of an algorithmic trading system
- Where required, suitable training should be provided

#### Testing

- There should be adequate testing of any algorithmic trading system and trading algorithms before providing such services to clients
- Testing should be carried out regularly and no less than annually

#### Risk Management

- There should be controls to ensure
  - Integrity of system and algorithms
  - Erroneous orders are not processed

## 5. MANAGEMENT, SUPERVISION AND INTERNAL CONTROL GUIDELINES FOR PERSONS LICENSED BY OR REGISTERED WITH THE SECURITIES AND FUTURES COMMISSION

### 5.1 Internal Control Guidelines (ICG)

- The Internal Control Guidelines (ICG) represent the way a business is structured and operated so there is reasonable assurance of:
  - Ability to carry on business in orderly and efficient manner
  - Safeguarding of its assets and clients' assets
  - Maintenance of proper records and reliability of financial and other information
  - Compliance with all applicable laws and regulatory requirements
- The ICG do not have the force of law

#### 5.1.1 Management and Supervision

##### Objective

- Management should establish and operate an effective management and operational structure which ensures that the business is conducted in a sound, efficient and effective manner

##### Control Guidelines

- Management are responsible for:
  - Development, implementation and ongoing **effectiveness of the Internal Controls**
  - Establishing **regular communication of control information** to various levels of management, including risks, detected weaknesses, non-compliance with laws and regulations, and any deviations from business principles
  - Identifying **clear reporting lines** with reporting responsibilities
  - Detailed **definitions of authorities** for key positions
  - Assignment of management functions to **suitably qualified and experienced persons**

#### 5.1.2 Segregation of Duties and Functions

##### Objective

- Incompatible duties and functions should be segregated, particularly those which, when performed by the same person, may provide opportunities for abuse or result in the overlooking of errors, thereby exposing the intermediary and its clients to risks

## Control Guidelines

- Line operations staff should not conduct the following duties:
  - Policy making
  - Supervision/advisory
  - Compliance
  - Internal audit
- Sales/dealing/accounting/settlement functions should be segregated from each other
- Research functions should be segregated from sales and dealing
- Where practical, research and corporate finance functions should be segregated
- Compliance and internal audit should be separate/independent, reporting directly to Management

### 5.1.3 Personnel and Training

#### Objective

- Recruitment and training policies and procedures should be established and implemented to ensure compliance with the intermediary's operational and internal control policies and procedures, and all applicable legal and regulatory requirements

#### Control Guidelines

- There should be procedures to employ fit and proper persons and to have them licensed/registered where necessary
- Provision of comprehensive and up-to-date information to staff covering policies and procedures
- Provision of adequate training for specific duties and to meet CPT requirements

### 5.1.4 Information Management

#### Objective

- Policies and procedures should be established to ensure the integrity, security, availability, reliability and completeness of all information and documentation relating to the business, in whatever form it is stored

## Control Guidelines

- Features of good information management are:
  - Information (physical or electronic) should be managed by qualified and experienced staff
  - The systems should be adequate and operated in a secure and controlled environment
  - Reporting requirements should be clearly defined to ensure that that internal and external reports are produced in time and contain the necessary information
  - Systems specifications are sufficiently documented and regularly reviewed for adequacy and effectiveness
  - Adequate and effective data security policies
  - Effective record retention policies which ensure that all legal and regulatory requirements are complied with

### 5.1.5 Compliance

#### Objective

- Policies and procedures shall be established to ensure that the intermediary and its staff comply with all applicable laws and regulations and with the intermediary's own internal policies and procedures

#### Control Guidelines

Management should:

- Establish and maintain an effective compliance function, independent of all operational and business functions
- Ensure compliance staff have the necessary skills, qualifications and experience
- Establish and enforce policies and procedures to provide compliance staff with full access to all necessary records and documentation
- Assist compliance staff to establish effective compliance procedures
- Establish proper complaint handling procedures (in writing)
- Establish prompt reporting to Management by compliance staff of material breaches of:
  - Legal and regulatory requirements
  - The intermediary's own policies and procedures
- Promptly report cases of material non-compliance with legal and regulatory requirements by the intermediary and its staff to the appropriate regulators

## 5.1.6 Audit

### Objective

- To establish and operate an audit policy and review function which independently examines, evaluates and reports on the adequacy, effectiveness and efficiency of the intermediary's management, Internal Controls and operations. The review functions can be performed by internal staff or external consultants, such as firms of accountants who may be asked to carry out ad-hoc or regular reviews

### Control Guidelines

- Management should establish internal audit as an independent function free of operating responsibilities, reporting directly to management
- The persons performing the internal audit function should have the necessary technical competence and experience
- Clearly defined terms of reference should set out the scope, objective, approach and reporting requirements
- Responsibilities and working relationship between internal and external auditors may be defined with the agreement of the external auditor
- Management should ensure adequate planning, control and recording

## 5.1.7 Operational Controls

### Objective

- To have effective policies, procedures and controls over day-to-day business operations which ensure:
  - Communications between the intermediary and its clients are in line with the Code of Conduct
  - The integrity of the intermediary's dealing practices and the fair, honest and professional treatment of clients
  - The safeguarding of client/intermediary assets
  - Reliable and accurate records/information are kept
  - Compliance with relevant legal and regulatory requirements



## Control Guidelines

- Management is required to establish policies and procedures to:
  - Obtain and confirm the true identity of every client, the beneficial owner of each client account and the persons authorized to give instructions for its operation
  - Obtain information regarding the client's financial position, experience and objectives
  - Establish precise terms and conditions for operating discretionary accounts, which should be communicated to the client
  - Ensure that any investment advice given for remuneration is supported by a contractual advisory agreement, and investment recommendations are made after thorough analysis, are suitable for the client, and are properly documented
  - Minimize the potential for conflicts of interest
  - Ensure that whenever the intermediary or its staff have a material interest in a transaction with a client, the fact is disclosed to the client prior to executing the transaction
  - Ensure that client orders are handled in a fair manner
  - Ensure that complete audit trails are created with records and times of orders received from clients or orders generated internally
  - Ensure that there is fair and timely allocation of client orders
  - Prevent the intermediary or staff from taking advantage of price-sensitive information or from participating in insider dealing
  - Prevent or detect errors, omissions, fraud and other unauthorized or improper activities
  - Protect the assets of clients and the intermediary from theft, fraud and other acts of misappropriation
  - Ensure that regular reconciliations of the intermediary's records with external records and reports are carried out

## 5.1.8 Risk Management

### Objective

- To establish and maintain effective policies and procedures to:
  - Ensure the proper management of risks
  - Identify and quantify risks
  - Provide timely/adequate information to enable Management to take action to contain and manage risks

### Control Guidelines

- The control guidelines provide for the establishment of:
  - a risk management function with suitably qualified and experienced professionals;
  - procedures to limit the exposure of the intermediary to risk of suffering loss to acceptable levels;
  - trading and position limits for proprietary trading and their monitoring at the end of the trading day;
  - comprehensive risk-focused reviews at suitable intervals or whenever there are significant changes in the business, operations or staff;
  - regular reporting of exposures and significant variances to management; and
  - risk policy defined by management including risk measurement and reporting methodologies

## 5.2 Additional Information about Operational Controls and Risk Management

### 5.2.1 Operational Controls

#### Account Opening

- Suggested control techniques and procedures may include:
  - Clear procedures strictly following the “know your client” principle
  - Recording all relevant client information
  - Reviewing information using management approved criteria
  - Advising the client about the firm services, risk disclosure, fees and other charges
  - Ensuring that the client is provided with information regarding his rights

#### Operating Discretionary Accounts

- The SFC suggests the following operational control techniques and procedures:
  - Executing a discretionary account agreement which includes: investment objectives; strategies; and terms
  - Regularly reviewing account performance
  - Providing regular client statements
  - Separating investment decision procedures from the dealing process

#### Providing Investment Advice

- Intermediaries being paid to advise on investments should:
  - Establish clear requirements and procedures on adequacy of research work
  - Document the rationale underlying the investment advice given and provide copies to clients
  - Provide clients with written details of applicable fees, charges and penalties

#### Dealing Practices (Order handling)

- Order handling procedures should cover:
  - Recording and time stamping of orders
  - Checks on availability of money and stocks to settle orders
  - Checks on any special instructions relating to the particular client, such as the operation authority and limits on the person making the order
  - Circumstances in which client orders may be delayed or withheld
  - Procedures for passing orders to the dealing room to ensure client priority and for correctly allocating orders

### Chinese Walls

- Measures should be taken to ensure that price-sensitive information is not leaked to operational staff

### Back Office and Accounting

- Deal tickets should be processed by back office and compared to external reports to identify errors and unusual trades
- There should be prompt confirmation of trades with clients using reliable methods
- Dealing errors should be recorded in a suspense account and investigated

### Asset Protection

- Suggested control techniques and procedures may include:
  - Establishing procedures for handling licensed or registered person and client assets
  - Maintaining reliable and adequate audit trails
  - Conducting regular compliance reviews and audits

## 5.2.2 Risk Management

### Identifying risk

- Intermediaries may face the following risks:
  - **Liquidity risk:** risk of not being able to meet commitments while maintaining assets
  - **Credit risk:** risk of a client or counterparty defaulting on an obligation
  - **Market risk:** risk of suffering a loss due to adverse movements in asset/liability market values
  - **Operational risk:** risk of losses from deficient or failed internal processes, systems or people
- All risks relevant to business should be identified
- All in organization should be aware of approach to risk
- Complexity of risk management should be appropriate to level of risk

### Measurement of risk

- Measurement method should be appropriate to nature, scale and complexity of activities

## Monitoring of risk

- Management information system should allow assessment and review of the effectiveness of its strategy, on a continuous basis
- Reporting lines and responsibilities should be clearly laid down

## Controlling risk

- In order to control risk, the system of internal controls should be appropriate to the nature, scale and complexity of activities
- Roles and reporting lines should be well-defined with segregation of duties
- Compliance function should be independent
- There should be regular compliance reviews and audits, with the results communicated to the Board
- Qualified risk management staff should be employed
- Risk management policies should be established
- Targets and limits should be set for absolute and relative amounts of exposure and regularly monitored
- Management should receive exposure and variance reports
- A contingency plan to address unexpected events should be in place, including raising funds to conserve or create liquidity

### 5.2.3 Risk Management Techniques

#### Credit risk

- Establish and maintain effective system to evaluate client and counterparty credit worthiness
- Set Appropriate credit limits for all clients
- Check
  - Client's credit rating
  - Past payment record and defaults
  - Client's capital base
  - Known events which might have an adverse impact
- Monitor exposure to clients, including pre-settlement and settlement
- Make appropriate haircuts to market value of securities pledged where credit extended for margin trading

### Market risk

- Place restrictions on instruments which can be traded
- Establish controls to ensure restrictions complied with
- Place trading and position limits on proprietary trading
- Risk managers should control open positions
- Establish measures to check effect of adverse market conditions, such as
  - Value at Risk methodology for general market risk
  - Sensitivity checks
  - Stress testing

### Liquidity risk

- Use liquidity measures
- Set concentration limits for products, markets and business counterparties
- Measure mismatches in timing of receipts and payables, receipt and delivery of products
- Monitor level of arrears and defaults
- Establish default procedures so liquidity managers have adequate time to take action

### Operational risk

- Segregation of duties
- Keeping secure, reliable, proper and up-to-date records
- Analysis of records to highlight adverse trends and to detect errors
- Employment of skilled and experienced staff
- Effective business continuity and disaster recovery plan
- Adequate insurance

## 6. VIRTUAL ASSETS AND FUTURES CONTRACTS

### 6.1 Introduction

- Since the first Bitcoin was issued in January 2009, **a wide range of different types of digital tokens have been issued**, based on some form of blockchain or distributed ledger technology
- A digital token is a **digitally written entry on a computer code** that is able to be controlled by one or more persons in accordance with the set of functions the computer code provides or permits
- **The SFC has defined digital tokens as “virtual assets”** irrespective of how they are referred to (e.g. a “cryptocurrency”, a “crypto- asset”, etc)

### 6.2 Hong Kong Regulatory Regime

- Where a virtual asset in substance amounts to a security or futures contract, as defined in the SFO, the usual laws and regulations will apply
- Conversely, where a virtual asset does not fall within the SFO definitions of securities or futures contracts, the SFO will not apply

### 6.3 Regulated Activities

- Although **the SFO does not apply to virtual assets that are not considered to be securities or futures contracts** (as defined in the SFO), there are a few important qualifications that need to be noted, as follows:
  - Where **an investment portfolio is structured as a CIS**, activities in relation to the CIS's shares or units will be subject to the SFO even though the investment portfolio might consist solely of virtual assets that are not securities or futures contracts
  - Following the launch of **futures contracts on cryptocurrencies** (such as Bitcoin and Ethereum) on regulated markets in the United States and the UK, dealing in or advising on such futures contracts will constitute Dealing in Futures (Type 2) and Advising on Futures (Type 5), respectively, irrespective of how the underlying assets would be regarded for the purposes of the SFO
  - Platforms that are sometimes called “cryptocurrency exchanges” or “cryptoexchanges” may trade in a variety of virtual assets. Where any one or more of those assets meet the definition of securities under the SFO, then the platform would need to be licensed or registered under the SFO

- Licensed corporations/registered institutions which intend to **provide trading or asset management services involving virtual assets**, should note that the SFC regards this as a significant change of activities, triggering the notification requirement under the Securities and Futures (Licensing and Registration) (Information) Rules

## 6.4 Investor Risks

- The SFC has listed the following set of **risks associated with investing in virtual assets**:
  - **Valuation, volatility and liquidity** – tokens are typically not backed by underlying physical assets or government guarantees, and price is frequently affected by short term speculation and small and fragmented liquidity pools
  - **Accounting and auditing** – there are no agreed standards among the accounting profession to ascertain ownership or reasonableness of valuations
  - **Cybersecurity and safe custody of assets** –billions of dollars have been lost through cyber attacks
  - **Market integrity** – markets that have formed around virtual assets are unregulated and subject to abusive practices
  - **Risk of money laundering and terrorist financing** – owing to the typically anonymous basis on which virtual assets are held and traded, there is a risk they may be used in connection with money laundering and terrorist financing
  - **Conflicts of interest** – operators of virtual platforms providing trading venues may act in various capacities that give rise to unregulated conflicts of interest
  - **Fraud** – insufficient due diligence may have been done in relation to disclosures made in relation to a virtual asset, raising the risk of fraudulent behaviour
  - **Leverage and complexity** – the highly leveraged nature of virtual asset futures contracts amplify the risk exposure



## 7. PREVENTION OF MONEY LAUNDERING AND TERRORIST FINANCING

### 7.1 General

- Money laundering refers to activities and processes intended to give illegally obtained money the appearance that it originates from a legitimate source
- Provisions for money laundering have been extended to terrorist financing
- In Hong Kong, money laundering is addressed through legislation, which is applicable to licensed corporations, registered institutions and associated entities
- The SFC has also issued guidelines to assist in compliance with the legislation

### 7.2 Hong Kong Legislation

- There are six pieces of legislation to be considered:
  - Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO)
  - Drug Trafficking (Recovery of Proceeds) Ordinance (DTRPO)
  - Organised and Serious Crimes Ordinance (OSCO)
  - United Nations (Anti-terrorism Measures) Ordinance (UNATMO)
  - United Nations Sanctions Ordinance (UNSO)
  - Weapons of Mass Destruction (Control of Provision of Services) Ordinance

#### 7.2.1 Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO)

- The objective of AMLO is to bolster the anti-money laundering regime in Hong Kong for the financial sector covering banking, securities, insurance and money changing. **In 2018, AMLO was extended** to cover solicitors, accounting professionals, real estate agents and trust and company service providers
- AMLO covers:
  - Customer due diligence requirements
  - Record keeping requirements
  - Giving “relevant authorities” (eg SFC and HKMA) the power to investigate and supervise licensed corporations and registered institutions for compliance with AMLO, and discipline when necessary
  - Establishment of a disciplinary review panel
- AMLO imposes a general duty on licensed corporations and registered institutions to:
  - Ensure proper safeguards to prevent contravention of the foregoing requirements
  - Mitigate money laundering risks
- A breach of the Ordinance is a criminal offence with a maximum penalty of HK\$1million and two years imprisonment; seven years if fraud is involved

### 7.2.2 Drug Trafficking (Recovery of Proceeds) Ordinance (DTRPO)

- It is an offence to deal with property known to, or believed to, represent the proceeds of drug trafficking
- Any person who knows or suspects that property relates to drug trafficking, should report it to a police officer, a customs and excise officer, or the Joint Financial Intelligence Unit (JFIU) – **failure to disclose is an offence**
- It is an offence to disclose to another person that a disclosure has been made, as above
- A person making a disclosure is excused from any resulting contract breach or professional obligation

### 7.2.3 Organised and Serious Crimes Ordinance (OSCO)

- Provisions are similar to DTRPO
- Police are given powers to obtain a court order to compel a person to provide information or material relating to the investigation
- Requirements to disclose and to submit to searches override any duties of secrecy and confidentiality

### 7.2.4 United Nations (Anti-terrorism Measures) Ordinance

- It is a criminal offence to provide financial services to terrorists or their associates
- Terrorist property can be frozen/forfeited
- It is an offence not to report knowledge or suspicions of terrorist property to an authorized officer

### 7.3 Guideline on Anti-Money Laundering and Counter-Terrorist Financing (GAML)

- As empowered by the AMLO, the SFC has issued guidance on implementing policies, procedures and controls to comply with the AMLO
- The GAML describes 3 common stages identified by the SFC in the process of money laundering:
  1. **Placement:** physical disposal of cash derived from illegal activities
  2. **Layering:** separation of the illicit proceeds from the source by creating a number of financial transactions (layers) – the most likely point at which a licensed corporation could become involved in a money laundering scheme
  3. **Integration:** creating an impression of legitimacy by bringing the proceeds back into the general financial system (without being connected with the illegal activity)
- The **GAML requires** licensed corporations to:
  - **Issue policies** and procedures to staff reflecting GAML provisions
  - Ensure that **staff understand** the GAML
  - **Regularly review** anti-money laundering policies and procedures through the compliance and audit functions
  - **Appoint** a money laundering reporting officer as a central reference point

#### 7.3.1 GAML Detailed Guidelines

##### Client Identification

- Client risk should be considered when carrying out CDD, taking the following into account:
  - Services that provide more anonymity
  - Non face-to-face account opening
  - Background/profile (eg politically exposed persons)
  - Unduly complex ownership structure
  - Nature of business – sensitive or high-risk activities
  - Nationality/place of incorporation
  - Means/types of payments
  - Countries with critical deficiencies in their anti-money laundering systems

### Ongoing Monitoring

- Client activities should be subject to ongoing monitoring to detect unusual or suspicious activities
- Activities of higher risk clients should be subject to more frequent and more intensive monitoring

### Record-keeping and Retention

- There should be a satisfactory audit trail
- **Customer documents** and information should be kept throughout the business relationship and for a period of **five years** after the end of the business relationship
- **Transaction documents** and information should be kept for **five years** irrespective of whether the business relationship ends during the period

### Recognition and Reporting of Suspicious Transactions

- Senior management and the money laundering reporting officer should be able to detect unusual or suspicious activities promptly
- Suspicious transactions will be unusual in relation to the client's business/financial circumstances

### Examples of Suspicious Transactions

- GAML provides a list of situations that might give rise to suspicions of money laundering activity:

#### Customer-related

- Requests for investment management services where source of funds are unclear or not in line with customer's financial background
- Opening of multiple accounts with same beneficial owners

#### Trading-related

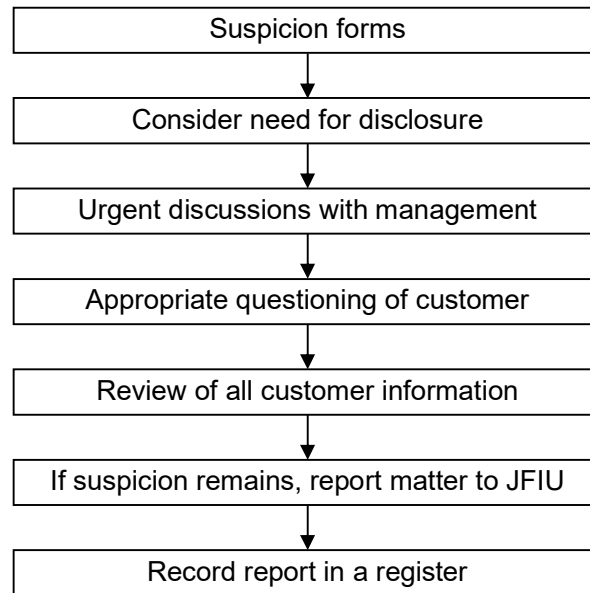
- Buying/selling activities with no obvious purpose
- Frequent small cash transactions followed by one sale transaction to a third party

#### Settlement/custody/transfers-related

- Large or unusual settlements in cash
- Idle client funds held by licensed corporation
- Frequent fund transfers/cheque payments to/from unverified third parties

#### Involving employees

- Changes in lifestyle: high spending or not taking holidays
- Unusual or unexpected increase in an employee's sales performance
- Forwarding addresses used for clients such as staff or persons connected to staff

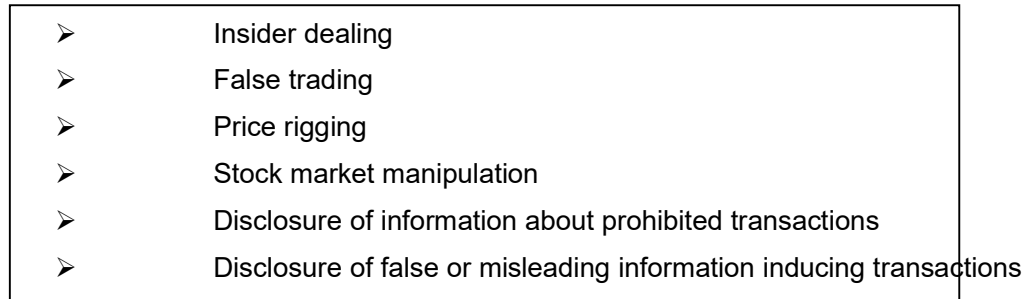
**Procedures for Disclosure (as suggested by JFIU)****Education and Training**

- Licensed corporations are required to regularly give staff information and training to keep them aware of:
  - Their obligations and potential liabilities
  - Policies and procedures relating to money laundering, including identification and reporting of suspicious transactions
  - New and emerging ways of money laundering

## 8. MARKET MISCONDUCT AND CONSEQUENCES

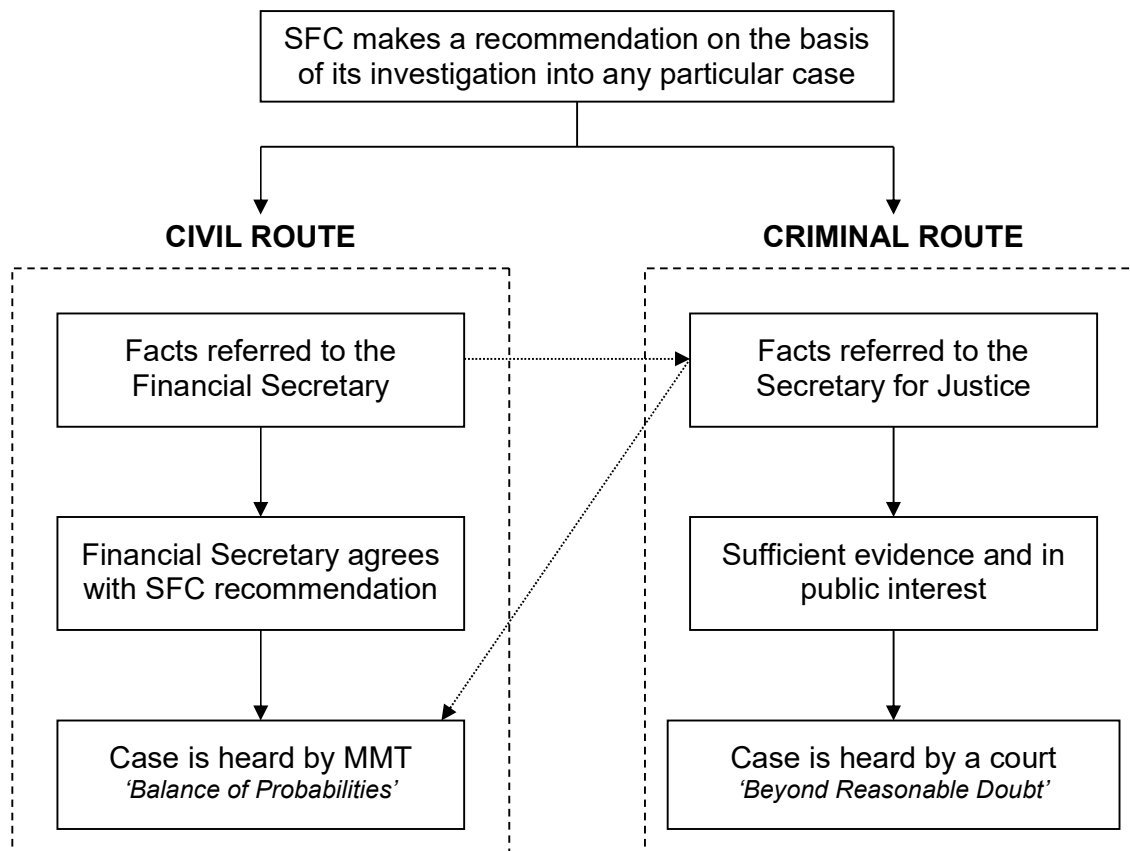
### 8.1. Market Misconduct Under the Securities and Futures Ordinance

- The SFO (Part XIII) defines six types of **market misconduct**:



- Legal proceedings against the accused can be **criminal** in the courts or **civil** under the Market Misconduct Tribunal (MMT), but not both (no “double jeopardy”)

### Criminal or Civil?



- The SFC has the power to prosecute minor cases summarily in a magistrate's court

## 8.2 Insider Dealing

### 8.2.1 Insider Dealing Definitions

**Insider dealing** is trading in securities while in possession of material non-public information obtained, directly or indirectly, in breach of a fiduciary duty or relationship of trust and confidence

#### Dealing

- A person dealing in Hong Kong listed securities of a corporation or its related corporation or their derivatives where the person:
  - Is **connected with the listed corporation** and knowingly has **inside information** in relation to the listed corporation; or
  - Is contemplating making a **take-over offer** for the listed corporation, which is known to the person as inside information in relation to the listed corporation
  - Has received such information which he knows is inside information directly or indirectly **from a person known to be connected** with the listed corporation

#### Tipping-off

- A person **connected** with a listed corporation disclosing **inside information or knowledge of a take-over offer** to another person knowing that the other person will make use of that information for dealing/counseling/procuring:

#### Inside Information

- Specific information in relation to a corporation:
  - Which is **not generally known** to persons who deal in its listed securities; but
  - If such information was known to them, it would be likely to **affect the security price** (ie price sensitive information)

#### Connected Persons

- A person connected with the corporation includes:
  - Directors/employees/substantial shareholders (at least 5% of shares)
  - Professionals who have a business relationship with the corporation (eg auditors)
  - Connected person of another corporation and the relevant information relates to transactions between the two corporations

## 8.2.2 Defenses Against a Charge of Insider Dealing

- There a number of possible defences per the SFO, including:
  - **Chinese wall** – an institution has both relevant information and trades the relevant securities, but the persons trading are not those possessing the relevant information
  - The purpose of the insider dealing was **not for the purpose of making a profit** or avoiding a loss
  - The dealing was a market contract
  - Dealing where the other party to the dealing knows or should know **the person dealing is a connected person**
  - **Exercising an existing right**, where the right was acquired prior to becoming aware of the relevant information

## 8.3 False Trading

- Occurs in relation to securities and futures contracts when:
  - A person intentionally or recklessly creates a false or misleading appearance of active trading or the market or the price
  - A person is involved in transactions, intentionally or recklessly, which create an artificial price or maintains a price at an artificial level
- A person is presumed to have engaged in false trading if he enters into **wash trades** or **matched orders**:
  - **Wash trade**: any transaction involving a sale and purchase of securities without a change in beneficial ownership
  - **Matched order**: an offer to sell (or buy) securities that is matched by an actual or proposed offer to buy (or sell) the same securities
- Defence can be that acts were not for the purpose of creating a false market

## 8.4 Price Rigging

- Price rigging is a type false trading and focuses on unacceptable forms of price fixing
- Price rigging takes place when a person:
  - enters into a **wash trade** which has the effect of maintaining, increasing, reducing, stabilizing or causing **fluctuations in the price of securities**; or
  - enters into, or carries out, a **fictitious or artificial transaction** or device, intentionally or recklessly, which has the effect of maintaining, increasing, reducing, stabilizing or causing **fluctuations in the price of securities or future contracts**

**Note:** False trading and price rigging only apply to transactions entered on-exchange or via an authorized automated trading service – they do not apply to off-market transactions



## 8.5 Stock Market Manipulation

- Stock market manipulation occurs when a person wishes to influence the investment decisions of other persons by:
  - Entering into two or more transactions which have the effect of increasing/reducing/maintaining/stabilizing the price of securities

- False trading, price rigging and stock market manipulation, as defined in the SFO, cover transactions carried out:
  - In Hong Kong, or elsewhere, in respect of instruments traded on a recognized stock market or on an ATS
  - In Hong Kong, in respect of instruments traded on an overseas market

## 8.6 Disclosure of Information about Prohibited Transactions

- If someone:
  - who is **party to a prohibited transaction**, or has received a benefit from such an act
  - **discloses, circulates or disseminates information** about the transaction, and its effect on prices of securities or futures contracts
  - he will have engaged in market misconduct
- An **acceptable defence** is if the person can show that he **acted in good faith** or did not receive a benefit from the party to the market misconduct

## 8.7 Disclosure of False or Misleading Information Inducing Transactions (Rumour Mill)

- If someone:
  - Makes intentional, reckless or negligent disclosure, circulation or dissemination of false or misleading information as to a material fact or its omission
  - which is likely to induce the subscription, sale or purchase of securities, or dealing in futures contracts, or
  - to increase, reduce, maintain or stabilize their prices,
  - then he is **engaged in market misconduct**
- A person who transmits or re-transmits the information, **acting as a conduit, in good faith**, will not be engaging in market misconduct
- **Bucketing**: it is an offence in Hong Kong to represent that a futures contract has been executed when in fact no such trade has been carried out. Often known as “bucketing”, although the term may mean different things in different markets

## 8.8 Safe Harbour Rules

- SFC may make “safe harbour” rules (i.e. exemptions) to ensure market misconduct rules do not prohibit legitimate and internationally acceptable market activities
- An example is the Securities and Futures (Price Stabilizing) Rules which permit and regulate price stabilizing action by issuers and underwriters in respect of public offerings

## 8.9 Fraud and Deception

- It is an offence in any securities transaction to:
  - Use any device, scheme or plan to defraud
  - Engage in any act or practice which is fraudulent or deceptive

## 8.10. Consequences of Market Misconduct

### 8.10.1 Market Misconduct Tribunal (MMT)

- The MMT is chaired by a judge with 2 other members who cannot be public officers. **All 3 are appointed by the Chief Executive** of HKSAR
- Can compel and receive evidence relevant to hearings
- A ‘**balance of probabilities**’ standard of proof is applied
- At the conclusion of proceedings, the **MMT will issue a public report** giving details of the market misconduct and the disciplinary orders handed out
- **Appeals** against MMT findings can be made to the Court of Appeal
- The MMT is subject to **judicial review**

### 8.10.2 Orders Made by the MMT

- **Orders that may be made by MMT** against those found to have committed market misconduct include:
  - **disqualification** for up to 5 years from holding office as director, liquidator, receiver or taking part in the management of a corporation;
  - **prohibition on investing** or trading in HK markets for up to 5 years (cold shoulder order);
  - **prohibition of further market misconduct** as specified in the order (cease and desist order);
  - **payment of profits made or loss avoided**, plus compound interest, to the Government;
  - **payment of reasonable costs** incurred by the Government and the SFC; and
  - **disciplinary referral orders** recommending that a professional body of which the person is a member should take disciplinary action against him

### 8.10.3 Criminal Sanctions Imposed by the Courts

- Criminal sanctions prescribed by the SFO are:
  - **10 years'** imprisonment and **HK\$10 million** on conviction and indictment; or
  - **3 years'** imprisonment and **HK\$1 million** on summary conviction
- A court may impose sanctions available to the MMT above

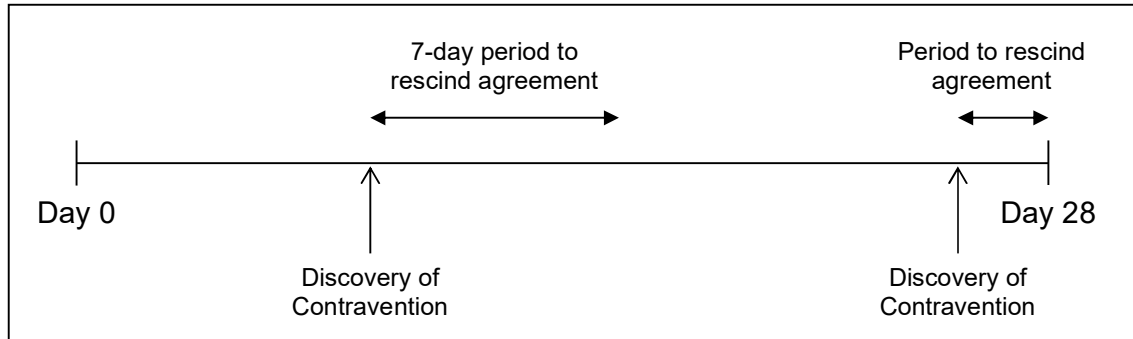
### 8.10.4 Private Civil Actions

- These are provided under Parts XIII and XIV of the SFO and include:
  - the right to sue for financial loss, even if there are no MMT hearings, criminal actions or convictions, however damages will only be paid if it is 'fair, just and reasonable'
  - the right to use MMT evidence in bringing such an action
  - injunctions
  - any reliefs under common law

## 9. UNSOLICITED CALLS

- Unsolicited calls include most possible forms of communication made by an intermediary with any person without his express invitation
- Persons exempt from the prohibition:
  - Existing clients
  - Licensed persons
  - Registered institutions
  - PIs
  - Solicitors/accountants acting in their professional capacity
  - Money lenders
- It is an **offence** to engage in the following acts **during an unsolicited call**:
  - Offering to make agreements to buy/sell financial products regulated by the SFC
  - Offering SMF
  - Offering to provide profits, income or other returns from dealing in such financial products
- The provisions are intended to protect the investing public from:
  - Recklessly giving personal details and money to a stranger
  - Believing a person giving financial advice without checking the person's status or background
  - Buying stock without checking the background of the issuer
  - Opening an account without taking proper precautions

- The person who enters into an agreement as a result of an unsolicited call may rescind the agreement by giving written notice within 28 days of the agreement or, if earlier, within 7 days of discovering the contravention



- The Securities and Futures (Unsolicited Calls – Exclusion) Rules state that the prohibition on unsolicited calls does not apply to:
  - Buying or selling securities which the person already owns
  - A “permissible communication”
- A permissible communication is one where
  - it is made to more than one person in identical terms
  - it is made by way of a system that creates a record of the communication which is then available to the recipient for later reference
  - it is made through a system which does not require an immediate response