CompliancePlus Consulting

Compliance Consulting • Funds Consulting
Regulatory Consulting • Compliance Training

Submission to Further Consultation on Proposed Disclosure Requirements Applicable to Discretionary Accounts (the "Proposal")

For enquiries on this submission, please contact Josephine Chung at jchung@complianceplus.hk.

CompliancePlus Consulting Limited understands and agrees that our name and/ or submission may be published to the public.

Executive Summary

The Securities and Futures Commission (the "**SFC**" or "**Commission**") has issued a Further Consultation on the Disclosure Requirements Applicable to Discretionary Accounts under the Code of Conduct (the "**Further Consultation Paper**") on 16 November 2017.

Terms defined or given a particular construction in the Further Consultation Paper have the same meaning in this Response unless a contrary indication appears.

Questions 1: Do you have any comments on the proposed disclosure requirement in relation to monetary and non-monetary benefits for discretionary accounts set out above?

We do not support the proposal to extend the disclosure requirements in relation to monetary and non-monetary benefits to be applicable to discretionary accounts as per the addition of Paragraph 7.2 under the section of Discretionary Accounts in the proposed Code of Conduct.

Furthermore, we are of the view that the proposed amended Paragraph 8.3(b)(ii) of the Code of Conduct should not apply to discretionary account managers as discussed below.

According to page 36 of the Consultation Conclusion, we know that the SFC received enquiries about whether the proposed amended Paragraph 8.3(b)(ii) of the Code of Conduct would apply to discretionary accounts but this has not been explicitly confirmed in the Consultation Conclusion.

On this note, we believe that the disclosure requirements under the proposed amended Paragraph 8.3(b)(ii) of the Code of Conduct would not apply to discretionary accounts as implied by the wordings "distributing an investment product".

Accordingly, it should be distinguished from the context of discretionary accounts where products are "purchased" for clients directly instead of "distributed" to them as the latter will defeat the discretionary nature of discretionary accounts.

We note that the SFC is attempting to respond to the above confusion by using explicit reference to "effecting a transaction in an investment product for a client" in the proposed wordings of amendment and by inserting the proposed provisions under Paragraph 7 of the Code of Conduct which is a section dedicated to Discretionary Accounts only.

We also note that the further proposed Paragraph 7.2 of the Code of Conduct has been a reduced version of the disclosure requirements under Paragraph 8.3 after the SFC received responses from the industry that it would be impossible to provide specified details as to the nature and amount of the monetary benefits received or retained by discretionary account managers for products purchased for their clients under discretionary portfolios prior to each transaction.

Nevertheless, we are of the view that no additional disclosure requirements shall be imposed on discretionary account managers. We find that the disclosure requirements to be excessive and impractical given the potential difficulties and operational burden faced by discretionary account managers to comply with such requirements.

We understand that the main source of income for Type 9 discretionary account managers is performance fees and management fees. In addition, they may also receive rebates and soft commissions but in any case all of the above have already been covered under the existing Code of Conduct i.e. Paragraph 13 on Retention of rebates, soft dollars and connected transactions that already imposed disclosure obligations on managers.

As a result, we are of the view that it would be unnecessary to introduce additional disclosure requirements in the context of Type 9 discretionary accounts.

In respect of the proposal that the disclosure requirements in question will apply when discretionary account managers deals with clients who are "individual" professional investors and can be exempted against "institutional" or "corporate" professional investors, we do not agree with such discrete treatment between different types of professional investors and we believe that it should be clear-cut that the requirements shall not be implemented at all regardless of the type of clients with which the discretionary account managers deal with.

In our reply to Question 2 below, we will further discuss our rationale of not supporting the present proposal with reference to the specific manner of disclosure as suggested in the proposal.

Questions 2: Do you have any comments on the suggested manner of disclosure set out above? Do you have any other suggestions to ensure the disclosure will be clear, fair, meaningful and easy to understand for investors?

Based on our view in Question 1, we believe no additional disclosure requirement shall be imposed to Type 9 discretionary account managers.

In particular, the practicality of the disclosure options as proposed in this Further Consultation Paper is questionable.

For Option 1, discretionary account managers may invest in a large variety of products for investors and some discretionary accounts may have multi-execution brokers, which makes the accurate disclosure of the monetary benefits received very difficult.

Different investment profile and objectives of discretionary account clients will also make the disclosure different leading to an increase in operational cost for discretionary account managers such as contract formation cost.

It may be quite impossible for managers to list out all the investment types at early stage of account opening with a maximum estimate that may easily render the disclosure not accurate or updated that may even cause confusion to clients as well.

For Option 2, it may easily provide inaccurate disclosure result from broad investment scope of some discretionary accounts that with different and changing assets allocation strategies that can be changed from time to time in a discretionary accounts under management by a manager that may render the disclosed maximum percentage of monetary benefits receivable by intermediary under discretionary account services not meaningful, not accurate and misleading to clients.
The SFC may also need to clarify the “assets under management” (“AUM”) in example (2) in paragraph 215 of the Further Consultation Paper refers to initial AUM

of the discretionary account or year-end AUM of discretionary account because the changes in AUM will affect the disclosure of the monetary benefits as well.

In any case, if we have to choose either Option 1 or Option 2 disclosure format, Option 1 seems a better option than Option 2 in terms of accuracy and certainty.

Questions 3: Do you think a six-month transition period following the gazettal of the final form of the amendments to the Code of Conduct is appropriate? If not, what do you think would be an appropriate transition period and please set out your reasons.

We would like to reiterate that we do not support the proposed amendments to the Code of Conduct. However, if the SFC insists on including such disclosure requirements applicable to discretionary accounts, we believe a longer transition period of at least 12 months is necessary following gazettal of the amendments to the Code of Conduct in order to provide market participants sufficient time to adjust to the new requirements.

We also want to draw the SFC attention to a drafting point of the addition of Para 15.4 (iii) of the proposed SFC Code of Conduct for making the Para 7.2 as an exemption for Corporate Professional Investor. If this is the case, the SFC may also need to consider whether similar exemption should also be made to Para. 8.3(b)(ii) for the same rationale and consistency sake for Corporate Professional Investor.

Conclusion

In conclusion, we do not support such disclosure requirements imposed on discretionary accounts given its impracticality and operational burden that will be faced by the discretionary account managers to comply with such requirements.

-END-