SFC
證監會

SECURITIES AND FUTURES COMMISSION 證券及期貨事務監察委員會
12th Floor, Edinburgh Tower, The Landmark, 15 Queen's Road Central, Hong Kong
香港中環皇后大道中十五號置地廣場公爵大廈十二樓

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Amendments to Client Identity Rules

On 17 July 2000 the Securities and Futures Commission (SFC) approved changes to the Client Identity Rule that is contained in the Code of Conduct For Persons Registered with the SFC (the SFC's Code of Conduct), and consequential changes to its Client Identity Rule Policy (Policy). The changes now restrict the operation of the rule to securities listed and futures contracts traded on the Hong Kong exchanges and to derivatives written over these securities and futures contracts. This should lighten the regulatory burden on intermediaries whilst at the same time meeting the primary purpose of the Client Identity Rule and Policy, namely to enhance the transparency of trading in Hong Kong's markets.

In December 1999, the SFC reviewed the operation of its own Client Identity Rule contained in paragraph C5.4 of the SFC's Code of Conduct and the associated Policy through a limited public consultation. Responses received indicated that a significant number of intermediaries were concerned about the application of the Client Identity Rule and Policy to transactions in non-Hong Kong traded financial products. Some also expressed concern about losing business as a result.

Having carefully considered these responses, the SFC decided to amend the Client Identity Rule and Policy so as to exempt from its operation securities not listed and futures contracts not traded on the Hong Kong exchanges and derivatives written over these. The changes will take effect upon their gazettal on 28 July 2000.

Contained in this package are:

- a new paragraph C5.4 of the SFC's Code of Conduct and a new Schedule II containing a Guidance Note for that paragraph; and
- an amended Client Identity Rule Policy.

If you have any questions on the matters contained in this package, please contact Eugene Goyne on 2840 9340 or Eva Tam on 2840 9536.

Encl.

SFC Code of Conduct
New client identity rule

5.4 (a) Subject to paragraph 5.4(e), a registered person must be satisfied on reasonable grounds about:

(i) the identity, address and contact details of:

(A) the person or entity (legal or otherwise) ultimately responsible for originating the instruction in relation to a transaction; and

(B) except in the case of 5.4(d) below, the person or entity (legal or otherwise) that stands to gain the commercial or economic benefit of the transaction and/or bear its commercial or economic risk; and

(ii) the instruction given by the person or entity referred to in paragraph 5.4(a)(i)(A).

(b) A registered person must keep in Hong Kong a record of the details referred to in paragraph 5.4(a) and give the Commission access to that record upon request.

(c) A registered person must not do anything to effect a transaction unless they have first complied with paragraphs 5.4(a) and (b).

(d) In relation to an investment fund (eg a mutual fund, unit trust, pooled retirement scheme, European CIS company, etc) or discretionary account the "entity" referred to in paragraph 5.4(a) is the investment fund or account and the manager of that investment fund or account, not those who hold a beneficial interest in that investment fund or account (eg the unitholders of a unit trust).

(e) Paragraph 5.4(a) applies only where the transaction involves securities or futures contracts that are listed or traded on one of the Hong Kong exchanges or a derivative, including an over the counter derivative, written over such securities or futures contracts.

Guidance note

(Schedule II)

The new rule, paragraph 5.4, requires that registered persons:

- satisfy themselves about information that identifies those who are ultimately responsible for originating instructions about a transaction and those who will ultimately benefit from a transaction or bear its risk and

- record that information in Hong Kong,

before doing anything to effect such a transaction.

The new rule supplements the existing "know your client" in paragraph 5.1 of the Code of Conduct.

The rule is intended to improve the transparency of trading in securities listed or futures contracts traded on one of the Hong Kong exchanges or in derivatives, including over the counter derivatives, written over such securities or futures contracts, wherever such trading occurs, by improving the information that is available to the Commission about the identity of those interested in transactions on those markets.

Like the rest of the Code of Conduct, the new rule uses simple language. Registered persons should interpret the rule sensibly in accordance with its spirit and not interpret the rule technically or literally. That is, registered persons must satisfy themselves about and record information that identifies those who are really behind a transaction: those who *ultimately* originate instructions in relation to a transaction and those who *ultimately* benefit from, or bear the risk of, that transaction. The Commission is concerned about the substance of what is going on with a transaction and not the technicalities.

For example, if a registered person's client was a company incorporated in the British Virgin Islands, the registered person would have to satisfy himself whether or not a shareholder or director of that company had originated the instructions in relation to the transaction and would receive the ultimate benefit from, or bear the risk of, the transaction. The registered person would also have to satisfy himself whether or not the company was being used as a nominee to conceal that person's identity. If it was the shareholder who turned out to be relevant and not the company, and the relevant shares turned out to be held on trust, the registered person would have to be satisfied about who was giving instructions in relation to the trust and who would benefit from, or bear the risk of, the transaction.

In relation to an investment fund or discretionary account, the Commission does not intend that registered persons concern themselves with those who have a beneficial interest in that investment fund or discretionary account, unless they are ultimately responsible for originating instructions in relation to a specific transaction.

For example, in relation to an investment fund or discretionary account, registered persons must only satisfy themselves about and record information about the fund or account and the manager of that fund or account if they are the person giving instructions. However, registered persons must record information about a beneficiary of the fund or account rather than the investment manager if that beneficiary has overridden the manager's discretion and originated the instructions in relation to a transaction.