



## FURTHER CONSULTATION ON PROPOSED DISCLOSURE REQUIREMENTS APPLICABLE TO DISCRETIONARY ACCOUNTS

### THE LAW SOCIETY'S SUBMISSIONS

The Securities and Futures Commission ("SFC") issued a paper on 16 November 2017 for "Further Consultation on Proposed Disclosure Requirements Application to Discretionary Account" ("**Further Consultation Paper**"). The Law Society provides the following submissions on the questions posed in the Further Consultation Paper.

#### **Overall response**

The Law Society welcomes the proposed changes as part of the SFC's wider efforts to address potential conflicts of interest and increase transparency in the asset management industry. The introduction of disclosure requirements with specific application to discretionary accounts is to be welcomed in light of the comments, highlighted in the previous consultation, regarding the difficulty in applying the requirements in Paragraph 8.3(b)(i) of the Code of Conduct for Persons Licensed by or Registered with the SFC ("**Code of Conduct**") (being more relevant for the broking industry).

***Question 1:** Do you have any comments on the proposed disclosure requirement in relation to monetary and non-monetary benefits for discretionary accounts set out in Part III of the Further Consultation Paper?*

#### **Law Society's response:**

We note that the disclosure requirements proposed for discretionary accounts, which are in respect of the *maximum percentage* of monetary benefits receivable, are consistent with the requirements applicable to fund managers. The consistency of regulatory treatment between the two areas of practice is to be welcomed given the move to align the treatment of fund managers and discretionary account managers under a single coherent framework.

We consider it is appropriate to include multiple options for disclosure to cater for different types of discretionary accounts.

Code of Conduct, Proposed Paragraph 7.2(a) - Monetary benefits under explicit remuneration arrangement

The new proposals reflect a move away from a ‘per transaction’-based approach to disclosure for discretionary managers, which is more intuitively aligned with the discretionary nature of the services provided.

*Option 1 – Specific disclosure by type of investment product*

We are in support of this approach as the operational burden for discretionary account managers to categorize benefits by product type should be relatively low, whilst at the same time providing the necessary clarity to investors.

*Option 2 – Specific disclosure of the aggregate amount in percentage terms*

Our comments below on Option 2 are from a more practical perspective.

We are in support of providing intermediaries with the alternative option to make disclosure by reference to a percentage of assets under management, but note that in practice, this option may be more suited for investment portfolios with a well-defined and relatively static ratio between product types.

For portfolios where the product ratio is constantly recalibrated (e.g. in response to market conditions, or changing investor risk appetite), or where the mandate does not indicate a specific ratio between different products types, the adoption of this method of disclosure may be more difficult to apply, or may require frequent recalculation and updating.

We also foresee that firms adopting this model of disclosure may opt to specify a high upper limit for convenience (to avoid constant recalculation and updating of disclosures) which may not be reflective of the actual level of benefits received, with the result that the disclosure may not be sufficiently meaningful for investors.

However we support the inclusion of this option as an additional option for those intermediaries who choose to adopt it.

Code of Conduct, Proposed Paragraph 7.2(b) - Monetary benefits under non-explicit remuneration arrangement and non-monetary benefits

We are in support of the approach to require generic disclosure in respect of benefits that are otherwise difficult to quantify in percentage terms.

We note that in Paragraph 8.3, Part B (a) of the Code of Conduct, brokers entering into transactions with/for clients must also disclose the nature of non-monetary benefits received. It is proposed that a similar requirement should apply to discretionary account managers for consistency of regulatory treatment, and to provide greater transparency for investors.

***Question 2:** Do you have any comments on the suggested manner of disclosure set out in Part III of the Further Consultation Paper? Do you have any other suggestions to ensure the disclosure will be clear, fair, meaningful and easy to understand for investors?*

**Law Society's response:**

The disclosure is stated to be required at the account opening stage or prior to entering into a discretionary client agreement. We propose that it should also be stated, for the sake of clarity, that it is also permissible to make the disclosure at the same time as entering into the client agreement, or prior to the commencement of discretionary management activities, in order to cater for cases where there is a time gap between signing and commencement.

***Question 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.*

**Law Society's response:**

The Law Society has no comment on the suggested timeframe. As a practical matter, intermediaries will need sufficient time to prepare and disseminate the relevant disclosures to clients and update existing documentation, so the views of industry participants should be sought in this regard.

**The Law Society of Hong Kong  
2 January 2018**

