



# Concurrent SFC-HKMA thematic review Of spread charges and other practices Mazars financial services newsletter Regulatory update series – Aug 2020

## Background and objectives

**On 18 May 2020, the Securities and Futures Commission (“SFC”) and the Hong Kong Monetary Authority (“HKMA”) announced that a concurrent thematic review on selected intermediaries will be carried out in the second half of 2020 to assess their spread charges and other practices as well as their compliance with requirements governing the disclosure of trading capacity and monetary benefits under the Code of Conduct for Persons Licensed by or Registered with the SFC (the “Code of Conduct”).**

The review will cover the following areas in relation to distribution to clients of non-exchange traded investment products such as bonds and structured products:

- policies and procedures,
- systems and controls, and
- senior management oversight

**Scope of the thematic review**

The review aims to ascertain that conflicts of interest in managing trades for clients are properly addressed. Specifically, the review shall cover the following areas:

- a. whether charges may be in excess of the spreads or fees disclosed in the standard documents to clients
- b. whether charges may be in excess of the spreads or fees as agreed with or understood by clients
- c. whether spread may be increased after a trade is executed and the price movement

is retained without agreement with or disclosure to clients

- d. whether intermediaries understand and properly disclose the capacity in which they are acting when conducting trades for clients

**Relevant regulatory requirements**

**A. General principles (“GP”)**

This thematic review focuses on a few general principles in the Code of Conduct as set out in the table below:

Expected behaviours of intermediaries	Code of conduct reference
✓ Act honestly and fairly	GP1
✓ Act with due skill, care and diligence	GP2
✓ Make adequate disclosure of relevant material information in dealings with clients	GP5, Paragraphs 8.3 & 8.3A
✓ Avoid conflicts of interest where possible	GP6
✓ Act in the best interest of clients	Paragraph 3.10
✓ Ensure clients are treated fairly	Paragraph 10.1

To comply with these requirements, intermediaries are expected to:

- put in place appropriate policies, systems, controls and management supervision over order handling and spread charges;

- properly disclose price, fees, monetary benefits received and trading capacity to clients; and

- maintain adequate records (e.g. telephone recordings) to ensure compliance with internal policies and procedures as well as with regulatory requirements and to enable

reviews or investigations by the intermediaries, their external auditors or regulators.

disclosure of monetary benefits and trading capacity as set out in sections 8.3 and 8.3A of the Code of Conduct.

**B. Specific Disclosure Requirements**

**Disclosure of monetary and non-monetary benefits**

The thematic review also covers requirements governing an intermediary's

<b>Monetary benefits</b>
<a href="#">Where monetary benefits are not quantifiable prior to or at the point of entering a transaction</a>
<b>Explicit remuneration arrangement</b> <ul style="list-style-type: none"><li>• Disclose the monetary benefits from the product issuer as a percentage ceiling of the investment amount or the dollar equivalent (Section 8.3 Part A(a)(i))</li></ul>
<b>Trading profit made from back-to-back transaction</b> <ul style="list-style-type: none"><li>• Disclose the trading profit to be made as a percentage ceiling of the investment amount of the dollar equivalent (Section 8.3 Part A(a)(ii))</li></ul>
Note: Disclosure should be made on a transaction basis and rounded up to the nearest whole percentage point or the dollar equivalent where possible

<b>Non-explicit monetary remuneration arrangement</b>
Disclose the fact that the intermediary or any of its associates will benefit from the origination and distribution of the product (Section 8.3 Part A(b)(i))
<a href="#">Where monetary benefits are not quantifiable prior to or at the point of entering a transaction</a>
Disclose the existence and nature of such monetary benefits, and the maximum percentage of such monetary benefits receivable per year (Section 8.3 Part A(b)(ii))
Note: Disclosure should be made on a transaction basis

<b>Non-monetary benefits</b>
Disclose the existence and nature of such non-monetary benefits from the product issuer (Section 8.3 Part B(a))

**Disclosure of transaction related information**

<b>Disclosure of transaction related information</b>
Information shall be disclosed to the client prior to or at the point of entering a transaction (including both selling investment product to and buying such product from client)

### Information to be disclosed

- I. The capacity (principal or agent) in which the licensed or registered person is acting
- II. Affiliation with the product issuer
- III. The licensed or registered person's independence with reference to paragraph 10.2 of the Code of Conduct and the bases for such determination
- IV. Monetary and non-monetary benefits
- V. Terms and conditions under which client may receive a discount of fees and charges
- VI. (Section 8.3A(a))

### Forms of disclosure

- I. In writing, electronically or otherwise (Section 8.3A(b))
- II. Independence should be disclosed in a specified form (Section 8.3A(b))
- III. Except for point (IV), a one-off disclosure is acceptable. Where there are any changes, there should be:
  - a. an updated one-off disclosure, or
  - b. an individual disclosure for each transaction with information deviated from the one-off disclosure (Section 8.3A(b))
- IV. Where provision of written information is not possible before the transaction is concluded, a verbal disclosure should be made, and written information to be provided as soon as practicable (Section 8.3A(c))
- V. Written form should be in Chinese or English according to the language preference of the client (Section 8.3A(d))

Note: The licensed or registered person should ensure the written disclosure is prominent, presented in a clear and concise manner, and easy for average clients to understand

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complex projects with multiple impacts, domestic and international.

Depending on the scope, coverage and specifics of your needs, our services would typically involve one or more of the following:

### A. Regulatory reviews and advice

- I. Review and provide advice on your institution's:
  - a. policies and procedures,
  - b. product disclosure mechanism and controls,
  - c. frameworks, and/or
  - d. operational capabilities.
- II. Provide observations and recommendations to assist you in complying with SFC and HKMA expectations and common industry practice.
- III. Provide pre-inspection advice or reviews.

## **B. Implementation of enhancements**

- I. Assist in designing and implementing enhancements to policies and procedures, governance frameworks, and conflict of interest management.
- II. Assist in designing the methodology for disclosure of monetary benefits and trading capacity.

## **C. Training and insights**

- I. Providing targeted training specific to your institution's unique product offerings, sales activities, and frameworks.
- II. Provide ongoing insights into how peer firms are dealing with the regulatory requirements and any common challenges encountered along the way.

We are flexible in our approach and offerings. Please feel free to contact us with any enquiries.

# Contacts

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