



29 October 2021

## Circular to intermediaries

### Findings of concurrent SFC-HKMA thematic review of spread charges and other practices

1. This circular shares some key observations noted from a concurrent thematic review conducted in 2020/21 by the Securities and Futures Commission (**SFC**) and the Hong Kong Monetary Authority (**HKMA**) (hereafter collectively referred to as the **Regulators**) of intermediaries' spread charges and related practices as well as their disclosure of transaction-related information.

#### Treatment and disclosure of price improvements, spread charges and pricing arrangements

2. Conflicts of interest can arise when intermediaries manage trades for clients. Upon receipt of a client request to buy or sell an investment product, the intermediary may agree on a limit order price<sup>1</sup> and place the client order to the market for execution. Price improvements occur when client orders are executed at better prices than the indicative prices quoted from the available counterparties when the order is taken.
3. The Regulators reviewed selected intermediaries' treatment of price improvements, including whether adequate policies and procedures had been put in place to govern the handling of benefits from price improvements and whether proper disclosure of the treatment of benefits arising from price improvements had been made to clients in cases where the intermediary would retain the benefits partially or in full.
4. The Regulators noted different practices amongst the selected intermediaries: some passed all the benefits from price improvements onto their clients, whilst others retained all or part of the benefits. A number of them failed to put in place proper policies and procedures for handling these benefits. The expected regulatory standards are set out below:
  - If an intermediary is acting as an agent for its client in a transaction, it should not retain the benefits from price improvements.
  - If an intermediary is acting as a principal in a back-to-back transaction<sup>2</sup>, the intermediary could retain the benefits, but it should disclose or agree this arrangement with its clients (see paragraph 8(e)).
5. In respect of spread charges and pricing arrangements, intermediaries may provide standard fee schedules to their clients, or enter into bilateral pricing agreements with them, and communicate the fees and charges to the clients prior to or at the point of the transaction. The Regulators reviewed the selected intermediaries' practices to ascertain

<sup>1</sup> The limit order price is usually set with reference to the best indicative price quote obtained by the intermediary from the available counterparties when the order is taken and the intended spread to be charged to the client.

<sup>2</sup> Paragraph 8.3(a)(ii) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**).

whether the spreads or fees charged conformed with the standard fee schedules or pricing arrangements as disclosed to or agreed with the clients. It was noted that some intermediaries:

- failed to put in place adequate controls and monitoring to ensure that the spreads or fees charged adhered to the fee schedules or bilateral pricing agreements agreed with the clients; or
- did not have clear and detailed guidance governing the establishment of bilateral pricing agreements.

#### Disclosure of transaction-related information

6. The Regulators also reviewed intermediaries' compliance with the regulatory requirements in relation to the disclosure of trading capacity, benefits and other transaction-related information as set out in paragraphs 8.3, 8.3A and 10.2 of the Code of Conduct.
7. The Regulators identified some instances of non-compliance with the transaction-related disclosure requirements and expect intermediaries to take measures to ensure compliance. The intermediaries concerned were required to undertake remedial action to address the issues identified. Key observations are set out in Annex 1 (for licensed corporations) and Annex 2 (for registered institutions).

#### Expected standards of conduct

8. Intermediaries are expected to, amongst other things:
  - (a) put in place proper policies, procedures and controls to govern the handling of post-trade spread amendments, price improvements, pricing arrangements (including but not limited to the establishment and approval of bilateral pricing agreements) and the disclosures required under paragraph 8.3A of the Code of Conduct;
  - (b) ensure that staff members understand the capacity in which the intermediary is acting in a transaction and that this is properly disclosed to clients;
  - (c) ensure that any bilateral pricing arrangements are agreed with clients in writing;
  - (d) disclose the monetary<sup>3</sup> and non-monetary benefits to clients in writing prior to or at the point of entering into the transaction – it will not suffice to meet the disclosure requirement under paragraph 8.3(a) of the Code of Conduct if an intermediary simply informs clients that the monetary benefits receivable from a product issuer for distributing an investment product or trading profits to be made from a back-to-back transaction are set out in a standard fee schedule<sup>4</sup> previously provided to the client

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<sup>3</sup> Intermediaries should make a specific disclosure of the monetary benefits or trading profit in the form of a percentage ceiling of the investment amount rounded up to the nearest whole percentage point or the dollar equivalent, prior to or at the point of entering into a transaction.

<sup>4</sup> Also applicable to bilateral pricing arrangements.

and asks the client to refer to it without making specific disclosure of the monetary benefits or trading profits prior to or at the point of entering into a transaction;

- (e) for back-to-back transactions where the intermediary acts as a principal, disclose to (which can be a one-off disclosure) or agree with clients prior to or at the point of the transaction in writing<sup>5</sup>:
    - it will not retain the benefits from price improvements; or
    - it will retain the benefits from price improvements and;
      - whether the benefits from price improvements would be fully or partially retained by the intermediary<sup>6</sup>; and
      - whether the intermediary would retain any amount of monetary benefits from price improvements in excess of the amount disclosed to clients prior to or at the point of entering into the transaction (**Changes**);
  - (f) if the intermediary retained monetary benefits which exceeded that disclosed to the client as a result of price improvements, disclose the actual amount of the Changes or the actual amount of the monetary benefit of the transaction to the client on a post transaction basis in writing as soon as possible<sup>5</sup>;
  - (g) clearly communicate internal policies and regulatory requirements to staff and provide them with appropriate training;
  - (h) implement pre-trade preventive controls and/ or post-trade detective controls to prevent or detect any deviations from the intermediary's policies and procedures;
  - (i) put in place an adequate reporting mechanism to ensure that any material breaches or deficiencies relating to pricing arrangements are brought to senior management's attention in a timely manner; and
  - (j) maintain proper records (including but not limited to provisions of the bilateral pricing arrangements) to demonstrate compliance with the requirements.
9. Senior management of intermediaries are reminded that they bear primary responsibility for ensuring appropriate standards of conduct and adherence to proper policies and procedures. They should review their systems, controls and procedures, having regard to the expected standards set out in this circular, and ensure compliance with the regulatory requirements under the Code of Conduct.

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<sup>5</sup> Intermediaries are expected to take actions to comply with the disclosure standards as soon as possible, but no later than six months from the date of this circular if major system or operational changes are needed.

<sup>6</sup> This is pursuant to General Principle 1 (honesty and fairness) and General Principle 6 (conflicts of interest) of the Code of Conduct.

10. Should you have any questions regarding the contents of this circular, please contact Ms Kammy Kwok on 2231 1455 or your case officer at the Intermediaries Supervision Department, Intermediaries Division of the SFC or Ms Eloise Pun at the Banking Conduct Department of the HKMA on 2878 1903.

Intermediaries Supervision Department  
Intermediaries Division  
Securities and Futures Commission

Banking Conduct Department  
Hong Kong Monetary Authority

Enclosure

End

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