SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

14 May 2019

Circular to licensed corporations

Recent inspection findings related to client facilitation

Conflicts of interest have long been a recurring regulatory concern. Over the years, the Securities and Futures Commission (SFC) has identified a number of conduct issues associated with client facilitation and provided guidance to the industry to address them[1]. Most recently, the SFC issued a circular in February 2018[2] to share the observations it made during a thematic review of client facilitation as well as its expected standards.

Expected standards

The standards of conduct and internal controls the SFC expects of licensed corporations (**LCs**) providing client facilitation services include:

(i) Controls, monitoring and management supervision

Policies and procedures should be established which cover the key areas relating to client facilitation such as client consent, order visibility, system access, the accuracy of indications of interest and position limits (emphasis added).

(ii) Segregation of agency and facilitation activities

For client facilitation orders, communications between agency and client facilitation traders should be recorded and monitored on a timely basis.

(iii) Consent and disclosure

*As LCs assume a risk-taking principal position against clients in client facilitation activities, the nature of the trades should be disclosed to clients and their **prior** consent obtained so that they are fully aware of the inherent conflicts of interest* (emphasis added).

(iv) Indications of interest (**IOIs**)

*IOIs should only be disseminated when they are based on a genuine client or proprietary intent to trade. IOIs should provide sufficient details, and controls and monitoring should be implemented to ensure they are **accurate** and updated in a timely manner* (emphasis added).

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1 For example, see the Press Release dated 16 December 2008.
2 Circular to licensed corporations on client facilitation, 14 February 2018.

Inspection findings

From mid-2018, the SFC has reviewed compliance with the expected standards in its inspections of selected brokers and found the following:

(a) Some traders misrepresented a house or client facilitation trade as an agency trade;

(b) Some traders were silent or not transparent about whether facilitation would be involved in a trade;

(c) Some traders failed to obtain explicit pre-trade consent from clients when effecting client facilitation trades;

(d) Some IOIs were described as natural although they were not based on a genuine client intent to trade; and

(e) Some firms' policies and procedures were not clear and could not ensure compliance with the expected standards, although they reported that their client facilitation policies were reviewed and enhanced in light of the February 2018 circular. For example, some of the prescribed in-house language and written notifications to clients described the nature of trades in an ambiguous manner.

The SFC takes these findings seriously and wishes to reiterate that brokerage firms and their traders should obtain <u>explicit</u> client consent <u>prior</u> to each client facilitation trade. Client consent should never be unidirectional, blanket, implied by the making of disclosure or obtained after the trade. More importantly, licensed individuals, when dealing with clients, should always act honestly and fairly.

The SFC will not hesitate to investigate any apparent improper conduct and non-compliance, and shall take regulatory action against the individuals (including relevant Managers-in-Charge) as well as the brokerage firms as appropriate.

LCs are advised to critically review existing policies and procedures and revise them as appropriate to ensure that they are clear, in full compliance with the expected standards and have been properly implemented and communicated to all relevant staff.

Should you have any questions regarding the content of this circular, please contact the relevant case officers in charge.

Intermediaries Supervision Department
Intermediaries Division
Securities and Futures Commission

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