

8 July 2019

Circular to Intermediaries

New measure to protect client assets

The Securities and Futures Commission (SFC) reminds intermediaries of their obligations to comply with the requirements under the Code of Conduct¹ when they are in possession or control of client assets. General Principle 1 of the Code of Conduct requires intermediaries, in conducting their business activities, to act honestly, fairly and in the best interests of their clients and the integrity of the market. In addition, paragraph 11.1(a) requires intermediaries to ensure that client assets are adequately safeguarded.

It has come to the SFC's attention that in some cases the standard Terms and Conditions entered into between intermediaries and authorised institutions (AIs) with respect to current, deposit or securities accounts that are client or trust accounts (collectively, Client Asset Accounts) contain clauses which grant AIs a right of set-off or lien. Such clauses are fundamentally incompatible with the requisite standard of protection afforded to client assets under the Code of Conduct.

Client asset acknowledgement letters

To strengthen the safeguarding of client assets, a standardised acknowledgement letter in the form of the template enclosed in [Appendix](#) is to be adopted and duly signed by both intermediaries and AIs.

The key elements of the acknowledgement letter include the notification of purpose clauses, the no-recourse clause and the conflict clauses. These clauses align with long-standing efforts by global regulators to protect investors and are similar to requirements imposed by regulators in other major jurisdictions.

The no-recourse clause in the letter template prohibits recourse against client assets in Client Asset Accounts. However, for the avoidance of doubt, in the event of an issuer's default, clawback by AIs of prepaid dividends or interest in respect of the issuer's securities would not be considered as recourse against client assets for the purposes of this requirement. In addition, the no-recourse clause does not apply to any recourse against assets required by legislation or court order.

The letter template further clarifies that in the event of any conflict between the client asset acknowledgement letter and any other agreement between the parties in connection with the Client Asset Accounts, the client asset acknowledgement letter shall prevail.

¹ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.



The client asset acknowledgment letter is applicable to and required for the following types of Client Asset Accounts which are opened with AIs in the name of intermediaries:

- (a) accounts for holding client money;
- (b) accounts for holding client securities; and
- (c) accounts for holding non-repledged clients' securities collateral².

To comply with this requirement, intermediaries shall prepare and sign client asset acknowledgement letters in accordance with the letter template in Appendix, and then obtain countersignatures from the appropriate AI.

Intermediaries are required to have the countersigned letters in place before depositing any client money or securities into any new Client Asset Accounts. The transition period for implementing this requirement ends on 31 July 2020, where the SFC expects the countersigned letters are in place for all applicable Client Asset Accounts.

Separately, the SFC would also like to remind intermediaries to exercise all due skill, care and diligence in the selection and appointment of any party other than an AI, including licensed corporation, with whom client assets are proposed to be placed, including whether the arrangements for the holding and safeguarding of client assets are in the best interests of its clients.

Should you have any queries regarding the contents of this circular, please contact your case officer.

Intermediaries Supervision Department
Intermediaries Division
Securities and Futures Commission

Enclosure

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² For the avoidance of doubt, intermediaries' accounts that hold clients' securities collateral repledged (with clients' authority) by intermediaries to AIs for obtaining financial accommodation from AIs are not subject to the requirement.