

4 November 2016

SFC notifies the industry of review on best execution and client facilitation

The SFC announced the commencement of a thematic review with focus on understanding the market practices in delivering best execution and providing client facilitation service.

Delivering best execution is fundamental to market integrity and to the delivery of good outcomes for clients who rely on execution agents to act in their best interests. The current rules and guidance on best execution, which are mainly addressed in the Code of Conduct¹ and Fund Manager Code of Conduct, have been used for years. Since markets are continuing to develop, market participants have been modifying their internal parameters in order to comply with the regulatory requirements. Some market participants have sought for clearer rules and guidance on both areas.

This thematic review is aimed at better understanding the operations and controls of the licensed corporations (LCs) in order to assess the industry's compliance with the relevant requirements. It is also aimed at better understanding the latest market development and challenges faced by the LCs, in order to provide input into our policy formulation to keep up with the evolution of the latest market practices.

During the course of SFC's routine inspections on the LCs in the past years, we note areas for improvement in their practices of best execution, client facilitation, and other related areas. The principal trading activities, including client facilitation, continue to evolve in global institutions. In 2014, we had held a supervisory briefing session that aimed at drawing industry's attention to common deficiencies and vulnerabilities identified in client facilitation during our routine inspections. In particular, we noted the following:

- Inadequate controls to avoid conflict of interest;
- Lack of priority to client orders over principal orders; and
- Deficiencies in monitoring issue of indications of interest.

The current thematic review was recently kicked off with an industry survey. Questionnaires, which have been issued to a wide range of LCs, mainly cover (i) governance structure, (ii) controls on order priority, (iii) adequacy of systems, (iv) monitoring and surveillance, (v) information for clients, and (vi) record keeping in relation to best execution and client facilitation.

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



In addition to the questionnaire, the thematic review comprises three more components:

- Dialogue sessions will be arranged with selected LCs. The dialogue sessions, which will be in the format of face-to-face meetings, are aimed at providing an opportunity for the selected LCs to outline their design and practices of delivering best execution and providing client facilitation service. During the sessions, LCs can also express their views on the current regulatory environment as well as elaborating more on their key challenges.
- Onsite inspections will then be conducted on selected LCs for a deep dive review, such that the SFC can gain an in-depth knowledge of the current market practice and also assess their controls and effectiveness in delivering best execution and providing client facilitation service to clients.
- A benchmarking exercise of the SFC regulatory requirements and market practices in Hong Kong against requirements of major financial services regulators and other relevant market practices will also be conducted.

All the above-mentioned components will be useful for the SFC to perform analysis and provide further guidance to the markets. The observations and findings of the review will be shared in due course.

Should you have any queries regarding the contents of this circular, please contact Ms Lorraine Chan on 2231 1751.

Intermediaries Supervision Department
Intermediaries Division
Securities and Futures Commission

End

SFO/IS/038/2016