STATEMENT OF DISCIPLINARY ACTION

The disciplinary action

1. The Securities and Futures Commission (**SFC**) has publicly reprimanded and fined Hang Seng Bank Limited (**HSB**)[1] HK$66.4 million pursuant to section 196 of the SFO for failures relating to its:

   (a) sale of collective investment schemes (**CIS**) during the period from 1 June 2016 to 30 November 2017 (**Relevant Period 1**);

   (b) sale and distribution of derivative products during the period from 17 February 2014 to 19 December 2018 (**Relevant Period 2**); and

   (c) retention of excess monetary benefits (**MB**), overcharging of clients and inadequate disclosure of fee arrangements during various periods between 3 November 2014 and 16 May 2023.

2. The relevant regulatory requirements are set out in the **Appendix**.

Summary of facts

A. HSB's sales practices in respect of CIS

A1. Background

3. The Hong Kong Monetary Authority (**HKMA**) identified a range of issues concerning HSB's CIS sales practices during Relevant Period 1 in an on-site examination that was concluded in December 2018 (**On-Site Examination**). Following that, HSB engaged an independent reviewer to conduct a look-back review (**Look-Back Review**) on certain client accounts and CIS transactions executed during Relevant Period 1, while the HKMA also conducted an investigation into HSB's CIS sales practices and referred its findings to the SFC.

A2. Failure to ensure "own-choice" transactions were conducted without solicitation and/or recommendation

4. The Look-Back Review identified 111 client accounts (**111 Accounts**) that have executed 100 or more CIS transactions during Relevant Period 1. Despite most of the CIS transactions conducted in the 111 Accounts being declared as client's "own choice" in questionnaires signed by the clients, the SFC identified from the HKMA's investigation findings accounts belonging to 46 clients (**46 Clients**) where:

   (a) HSB's relationship managers (**RMs**) proactively encouraged and/or induced the clients to enter into transactions;

   (b) the RMs provided advice and recommendations to the clients; and

[1] HSB is registered to carry on Type 1 (dealing in securities), Type 4 (advising on securities), Type 7 (providing automated trading services) and Type 9 (asset management) regulated activities under the Securities and Futures Ordinance (**SFO**).

(c) the clients asked the RMs to provide recommendations and the RMs did so.

5. This indicates HSB has failed to ensure that these transactions which were declared by clients to be made of their "own-choice" were conducted without solicitation and/or recommendation on the part of HSB.

A3. Failure to ensure suitability of investment recommendations and/or solicitations made to its clients

6. HSB has also failed to ensure that its recommendations or solicitations made to the 46 Clients were suitable for and reasonable in all the circumstances of the clients. In particular, the investigation found that RMs have procured clients into conducting frequent CIS transactions, which led them to incur substantial transaction costs.

Frequent CIS transactions

7. An analysis of the transactions in the accounts of the 46 Clients revealed that:

(a) the 46 Clients each conducted between 100 and 253 CIS transactions during a period of 18 months;

(b) in 24 out of the 46 Clients' accounts, at least 60% of the funds were redeemed or switched out within 15 days of purchase; and

(c) at least 90% of funds belonging to the 46 Clients were redeemed or switched out within six months of purchase.

8. Such frequent trading patterns generally contradicted both the intended investment objectives of the CIS products that were being traded and the preferred investment tenor of the affected clients.

Substantial transaction fees

9. The 46 Clients paid substantial transaction fees for their frequent CIS transactions, reaching over HK$3.8 million in one case, which represented a major portion of their losses. 67% of the 46 Clients suffered losses of up to HK$3.3 million. Even with respect to the remaining accounts with profit, the transaction fees incurred were higher than the profit yielded in 86% of cases.

10. HSB's failure to:

(a) ensure that its clients' "own-choice" transactions were conducted without solicitation and/or recommendation; and

(b) ensure that its recommendations or solicitations made to clients were suitable for and reasonable in all the circumstances of its clients,

constitute breaches of GP 2 (Diligence) and paragraphs 3.4 and 5.2 of the Code of Conduct. HSB's conduct also fell short of the regulatory standards highlighted in the Annex to the 2016 Circular, in particular those highlighted in paragraph 3 thereof.

A4. Lack of adequate and effective internal controls and systems to supervise and monitor the sale of CISs

11. The investigation also found that HSB did not have adequate and effective internal controls and systems in place at the relevant time to diligently supervise and monitor the sale of CIS:

    (a) **Lack of audit trail for "own-choice" mechanism**: HSB's systems would automatically generate CIS products determined to be suitable for a particular client, but clients could request to invest in other products by declaring that the investment was the result of their own decision. Apart from the clients' signed declarations, HSB did not maintain any other records evidencing whether the transactions were solicited or recommended by its RMs to its clients.

    (b) **Client call-backs**: HSB's Retail Business and Wealth Management Business Internal Control team (**RIC**) would conduct client call-backs on frequent trading accounts with over 15 transactions in a month (**Call-Back Program**). It was found, however, that there was an inadequate assessment of the trading pattern of accounts during such call-backs.

    (c) **Management reporting:** while RIC would prepare monthly reports to senior management to document the results from the Call-Back Program, these reports were lacking in that they would typically only list out bare statistics, and would not include any analysis of the same or other important information.

12. In light of the above, the SFC is of the view that HSB did not have adequate systems in place to monitor and supervise the sale of CIS products to its clients, in breach of GP 7 (Compliance) and paragraphs 4.2, 4.3 and 12.1 of the Code of Conduct and paragraph VII(8) of the Internal Control Guidelines. HSB's internal controls in connection with its CIS sales practices also fell short of the regulatory standards highlighted in the Annex to the 2016 Circular, in particular those highlighted in paragraph 3 thereof.

B. HSB's sale and distribution of derivative products

B1. Background

13. In March 2019, HSB reported to the HKMA and the SFC that certain HSB clients who were not characterized by HSB as having knowledge of derivatives might have subscribed for derivatives funds via HSB. The HKMA conducted an investigation into the matter and referred its investigation findings to the SFC.

B2. Failure to ensure risk mismatch transactions in derivative products were suitable for the clients or otherwise in their best interests

14. Under HSB's internal policy applicable during Relevant Period 2, only clients who were characterized by HSB as having a general knowledge of the nature and risks of derivatives (**Knowledge**) were permitted to purchase a derivative product.

15. However, the SFC found that, during Relevant Period 2:

    (a) 388 clients who were not characterized by HSB as having Knowledge had purchased derivative funds via HSB online banking in 629 transactions (**629 Impacted Transactions**); and

    (b) among the 629 Impacted Transactions, 148 transactions executed for 121 clients involved a risk mismatch, i.e. the product risk level was higher than the clients' risk tolerance level (**Risk Mismatch Transactions**).

16. With respect to the Risk Mismatch Transactions, despite the fact that the derivative funds were assessed to be unsuitable for the clients according to the results of the risk mapping performed, HSB merely brought this to their attention through an alert message and let the clients decide whether or not to proceed with the transactions by acknowledging the alert message. HSB did not take any further actions to ensure that the transactions were in the best interests of the clients.

17. As a result, the SFC considers that HSB failed to ensure Risk Mismatch Transactions in derivative products were suitable for its clients or were otherwise in their best interests, in breach of GP 2 (Diligence) and paragraph 5.1A(b)(ii) of the Code of Conduct.

B3. Failure to implement appropriate measures to ensure HSB's sale and distribution of derivative products were in compliance with all regulatory requirements

18. HSB had put in place controls which were designed to restrict clients who did not have Knowledge from investing in derivative funds:

    (a) clients who had Knowledge were assigned an investor characterization (**IC**) status in HSB's databases;

    (b) funds which were classified as a derivative product were flagged in HSB's Group Hub Securities System (**GHSS**) and e-Investment Centre (**e-INVC**) (collectively, **Flags**); and

    (c) HSB only accepted a subscription for derivative funds from a client with IC status or a client without IC status who had completed derivatives product training before the subscription.

19. When a client placed an order for a derivative fund at an HSB branch, his IC status would be matched against the Flags in both GHSS and e-INVC. Whereas when a client placed an order for a derivative fund via online banking, his IC status would only be matched against the fund's Flag in GHSS.

20. Due to human oversight and lack of system interface in respect of the Flags between e-INVC and GHSS, some derivative funds were not correctly flagged in GHSS when they were reclassified from being a non-derivative product to a derivative product (**Incident**). As a result, clients with non-IC status could subscribe for some derivative funds through HSB's online banking without completing the relevant training as these funds had not been correctly flagged in GHSS.

21. In light of the above, the SFC found that HSB did not implement appropriate measures to prevent the occurrence and ensure timely detection of the Incident to ensure its sale and distribution of derivative products were in compliance with all regulatory requirements. The Incident was not detected by HSB for over 4 years. The SFC considers that HSB was accordingly in breach of GP 7 (Compliance) and paragraph 12.1 of the Code of Conduct.

C. HSB's retention of excess MB, overcharging of clients and inadequate disclosure of fee arrangements during various periods between 3 November 2014 and 16 May 2023

C1. Background

22. Between October 2021 and May 2023, HSB submitted a number of self-reports to the HKMA and the SFC concerning its retention of excess MB, overcharging of clients and inadequate disclosure of fee arrangements in transactions with its retail, private banking and corporate clients. The SFC has conducted an investigation into the issues raised in the self-reports in collaboration with the HKMA.

C2. Retention of MB from price improvements in secondary market bonds transactions with retail clients

23. During the period from 3 November 2014 to 1 June 2021, when HSB acted in the capacity of principal in distributing secondary market bonds to its retail clients, HSB's sale staff would provide a quotation to the client (**Client Price**) after seeking an internal quotation through HSB's systems (**HSB Price**). The sales staff would disclose the maximum amount of MB receivable by HSB from the transaction as a percentage ceiling of the Client Price (**Disclosed MB**).

24. Due to:

    (a) a lack of guidelines documenting which specific team/department involved in the distribution of secondary market bonds to its retail clients was responsible for ensuring that HSB did not receive MB exceeding that disclosed to the clients; and

    (b) a lack of internal controls to deal with transactions in which there was a price improvement between the client's order placement and HSB's execution of the order,

    HSB received MB in excess of its Disclosed MB in certain sell orders and buy orders.

25. HSB received over US$540,000 (i.e., over HK$4.2 million) in excess of the MB disclosed to 309 retail clients in 349 bond transactions (**Excess MB**). By retaining the Excess MB, HSB deprived its clients of the opportunity to benefit from the price improvements which occurred in respect of their transactions.

*C3. Retention of MB from price improvements in transactions in bonds, certificates of deposits (**CDs**), US Treasury bills (**T-Bills**) and structured notes conducted on behalf of private banking and corporate clients in the secondary market*

26. During the periods from 2 March 2016 to 21 February 2023 and from 17 May 2016 to 13 July 2022, HSB's Private Bank Department (**PBD**) and Corporate Wealth and Sales Management Department (**WSM**) respectively acted in the capacity of agent in relation to secondary market bonds, CDs and secondary structured notes distributed to their respective clients. WSM also distributed T-Bills to their clients as agent.

Distribution of secondary market bonds, CDs, and T-Bills

27. Due to insufficient awareness regarding the handling of price improvements when HSB acted in the capacity of agent, HSB's staff incorrectly assumed that price improvements caused by market fluctuations between order placement and order execution could be retained by HSB as additional MB, provided that the overall income received from the relevant transaction did not exceed the "all-in" price disclosed to the client (which comprised the prevailing market price at the time of order placement and the initial commission amount intended to be charged by HSB).

28. Accordingly, in transactions where there was a price improvement between order placement and order execution, instead of allowing clients to benefit from the price difference, bank staff amended the commission amount in HSB's system such that the price improvements (or parts thereof) were recognized as additional commission and thereby retained by HSB.

Distribution of secondary structured notes

29. As regards secondary structured note orders placed by clients of PBD and WSM, the "all-in" price communicated to the client could not be altered in HSB's systems after order execution. Therefore, where the final executed price was better than the initial price (which was determined with reference to the executed price for the primary issuance), HSB's staff were not able to reallocate the price improvement to the client by amending the client order price. Therefore, instead of allowing clients to benefit from the price difference, the price improvement was retained by HSB. The same practice was followed for orders placed by private banking clients by paper ticket.

30. As a result, HSB unduly received MB resulting from price improvements in the amount of:

    (a) over HK$1.5 million from 651 transactions conducted by 310 private banking clients; and

    (b) HK$11.1 million from 1,370 transactions conducted by 315 corporate clients.

C4. Retention of MB in excess of amounts disclosed in relation to bond transactions conducted on behalf of private banking clients in the primary market

31. During the period from 4 May 2016 to 15 July 2021, PBD transacted in bond products on the primary market on behalf of its clients. PBD's practice was to disclose the MB receivable to clients based on the investment amount of the products, which was the amount which the client would pay when subscribing for a primary bond.

32. However, contrary to PBD's disclosure practices, HSB's system calculated the actual MB based on the notional amount of the bond instead of the client's investment amount. Accordingly, in situations where this amount exceeded the investment amount (i.e., where a bond was offered at a discount), HSB retained MB in excess of its disclosed amount, instead of allowing the client to benefit from the price difference.

33. As a result, HSB retained excess MB of over HK$37,000 from 234 primary bond transactions conducted on behalf of 135 private banking clients.

C5. Charging more than disclosed fees in respect of services provided to private banking and corporate clients

PBD's conduct

34. During the period from 4 March 2016 to 17 February 2023, the fees and charges for various services[2] offered by PBD to its clients were communicated to them by way of a fees and charges schedule (**PBD Fees and Charges Schedule**). However, charges in excess of those set out in the PBD Fees and Charges Schedule occurred in two broad instances:

    (a) First, prior to January 2022, HSB's internal policies permitted the approval of fees and charges that were higher than those stated in the PBD Fees and Charges Schedule. Therefore, cases arose where PBD staff sought and obtained permission to apply charges in respect of PBD's Services above the relevant amounts stipulated in the PBD Fees and Charges Schedule.

    (b) Second, in relation to investment fund switching and T-Bill transactions, under the PBD Fees and Charges Schedule, fee ceilings were specified for different types of switching (switching within the same fund house or between different fund houses) and for T-Bill transactions (as opposed to transactions in standard bonds), but bank staff in certain instances mistakenly applied the wrong, and higher, fee ceilings than those stipulated PBD Fees and Charges Schedule.

35. As a result, HSB overcharged its clients fees totaling over HK$5 million in 217 transactions conducted on behalf of 73 private banking clients.

[2] Including transactions in bonds, T-Bills, stocks and investment fund products (**PBD's Services**).

WSM's conduct

36. During the period from 3 January 2017 to 7 March 2023, the fees and charges for various services[3] offered by WSM to its clients were also communicated to them by way of a fees and charges schedule (**WSM Fees and Charges Schedule**).

37. WSM staff would decide the commission percentage to be applied for each transaction by reference to the applicable ceiling, but there were instances where WSM staff mistakenly relied upon a higher ceiling percentage than that stated in the WSM Fees and Charges Schedule.

38. As a result, HSB overcharged its clients fees totalling over HK$550,000 in relation to 35 transactions conducted on behalf of 14 corporate clients.

C6. Failure to adequately disclose trailer fee[4] arrangements to private banking clients trading in investment funds

39. During the period from 17 August 2018 to 16 May 2023, when processing fund subscription and switching transactions, PBD protocol was for staff to provide the client with an Investment Fund Subscription and Switching Application Form (**IF Subscription Form**), which would include a written disclosure of the trailer fees applicable.

40. However, when PBD processed fund subscription or switching transactions via telephone orders, the IF Subscription Form was not provided to clients. As a result, in respect of these transactions, HSB only disclosed the trailer fee arrangements to clients verbally before trade, and failed to provide post-trade written disclosure of the same.

41. During the period in question, PBD conducted 5,716 investment fund transactions (**Fund Transactions**) on behalf of 1,057 clients. HSB was unable to provide information regarding the number of Fund Transactions in respect of which clients were not provided with a copy of the IF Subscription Form (and accordingly the amount of trailer fees received in connection with such transactions).

C7. Regulatory failures

42. In light of the findings set out at paragraphs 23 to 41 above, the SFC is of the view that HSB has failed to comply with:

    (a) GP 2 (Diligence), GP 3 (Capabilities), GP 5 (Information for clients) and GP 6 (Conflicts of interest) of the Code of Conduct;

    (b) paragraphs 2.1, 2.2, 3.2, 4.2, 4.3, 8.3(A)(c) and 10.1 of the Code of Conduct; and

    (c) paragraphs V(4), VII(4) and VII(8) of the Internal Control Guidelines.

43. HSB's conduct also fell short of the regulatory standards highlighted in paragraphs 4 and 8 of the 2021 Circular.

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[3] Including transactions in bonds, T-Bills, CDs and investment fund products.

[4] Trailer fees refer to commissions provided by fund houses to HSB in connection with its role in the distribution of funds.

Conclusion

44. In the circumstances, the SFC is of the opinion that HSB is guilty of misconduct.

45. In arriving at the sanctions set out at paragraph 1 above, the SFC has had regard to its Disciplinary Fining Guidelines and taken into account all relevant considerations, including the following:

    (a) HSB's CIS-related failures exposed its clients to significant loss;

    (b) HSB's MB-related failures occurred during various periods over the course of nine years and caused its clients to have been improperly charged fees of at least HK$22.4 million;

    (c) a strong message needs to be sent to the market to deter other market participants from allowing similar failures to occur;

    (d) HSB compensated clients for their loss and also refunded the excess MB retained;

    (e) HSB commissioned a number of internal and independent reviews upon discovery and self-reporting of its misconduct and enhanced its internal controls;

    (f) HSB's cooperation with the HKMA and the SFC and acceptance of the SFC's findings and disciplinary action facilitated an early resolution of the matter; and

    (g) HSB has no previous disciplinary record.

Appendix

Relevant Regulatory Standards

*Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**)*

1. General Principle (**GP**) 2 (Diligence) of the Code of Conduct requires a registered person to act with due skill, care and diligence, in the best interests of its clients and the integrity of the market in conducting its business activities.

2. GP 3 (Capabilities) of the Code of Conduct requires a registered person to have and employ effectively the resources and procedures which are needed for the proper performance of its business activities.

3. GP 5 (Information for clients) of the Code of Conduct requires a registered person to make adequate disclosure of relevant material information in its dealings with its clients.

4. GP 6 (Conflicts of interest) of the Code of Conduct requires a registered person to try to avoid conflicts of interest, and when they cannot be avoided, to ensure that its clients are fairly treated.

5. GP 7 (Compliance) of the Code of Conduct requires a registered person to comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.

6. Paragraph 2.1 of the Code of Conduct provides that where a registered person advises or acts on behalf of a client, it should ensure that any representations made and information provided to the client are accurate and not misleading.

7. Paragraph 2.2 of the Code of Conduct requires charges, mark-ups and fees affecting a client should be fair and reasonable in the circumstances, and be characterized by good faith.

8. Paragraph 3.2 of the Code of Conduct provides that a registered person when acting for or with clients should execute client orders on the best available terms.

9. Paragraph 3.4 of the Code of Conduct requires a registered person, when providing advice to a client, to act diligently and carefully in providing the advice and ensure that its advice and recommendations are based on thorough analysis and take into account available alternatives.

10. Paragraph 4.2 of the Code of Conduct requires a registered person to ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed by it to conduct business on its behalf.

11. Paragraph 4.3 of the Code of Conduct requires a registered person to have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients and other licensed or registered persons from financial loss arising from theft, fraud and other dishonest acts, professional misconduct or omissions.

12. Paragraph 5.1A(a) of the Code of Conduct provides that a registered person should, as part of the know-your-client procedures, assess the client's knowledge of derivatives and characterize the client (other than professional investors for the purpose of paragraph 15 of the Code of Conduct (**Professional Investors**)) based on his knowledge of derivatives.[1]

13. Paragraph 5.1A(b)(ii) of the Code of Conduct provides that where a client without knowledge of derivatives wishes to purchase a derivative product which is not traded on an exchange and the registered person has not solicited or made a recommendation to the client in relation to the proposed transaction, the registered person should:

    (a) warn the client about the transaction;

    (b) having regard to the information about the client, particularly the fact that he/she is a client without knowledge of derivatives, provide appropriate advice to the client as to whether or not the transaction is suitable for the client in all the circumstances;

    (c) keep records of the warning and other communications with the client; and

    (d) where the transaction is assessed to be unsuitable for the client, proceed to effect the transaction only if to do so would be acting in the best interests of the client in accordance with the general principles of the Code of Conduct.

14. Paragraph 5.2 of the Code of Conduct provides that a registered person should, when making a recommendation or solicitation, ensure the suitability of the recommendation or solicitation for that client is reasonable in all the circumstances having regard to the information about the client of which the registered person is or should be aware through the exercise of due diligence.

15. Paragraph 8.3(A)(c) of the Code of Conduct provides that, in circumstances where provision of information in respect of monetary benefits, among other things, in written form is not possible before a transaction is concluded, the registered person should make a verbal disclosure and provide such information in writing to the client as soon as practicable after the conclusion of the transaction.

16. Paragraph 10.1 of the Code of Conduct provides that, where a registered person has a material interest in a transaction with or for a client or a relationship which gives rise to an actual or potential conflict of interest in relation to the transaction, it should neither advise, nor deal in relation to the transaction unless it has disclosed that material interest or conflict to the client and has taken all reasonable steps to ensure fair treatment of the client.

17. Paragraph 12.1 of the Code of Conduct requires a registered person to comply with, and implement and maintain measures appropriate to ensuring compliance with relevant regulatory requirements.

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[1] Paragraph 5.1A(a) of the Code of Conduct was updated on 24 March 2016 to the effect that the Professional Investors exemption was no longer applicable thereafter.

*Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission (**Internal Control Guidelines**)*

18. Paragraph V(4) of the Internal Control Guidelines provides that staff performing the compliance function, in conjunction with management, should establish, maintain and enforce effective compliance procedures. These procedures should cover legal and regulatory requirements including where applicable record keeping (for management and regulatory reporting, audit and investigations).

19. Paragraph VII(4) of the Internal Control Guidelines provides that specific policies and procedures should be established to minimize the potential for the existence of conflicts of interest between the firm or its staff and clients, and further, in circumstances where actual or apparent conflicts of interest cannot reasonably be avoided, that clients are fully informed of the nature and possible ramifications of such conflicts and are in all cases treated fairly.

20. Paragraph VII(8) of the Internal Control Guidelines provides that a registered person should establish and maintain appropriate and effective procedures in relation to dealing and related review processes to prevent or detect errors, omissions, fraud and other unauthorised or improper activities, and which ensure the fair and timely allocation of trades effected on behalf of clients.

*Circular entitled "Feedback from recent reviews of the selling of investment products" issued by the HKMA on 8 April 2016 (**2016 Circular**)*

21. On 8 April 2016, the HKMA issued a circular to all authorized institutions (**AIs**) sharing some key observations and practices it had identified in the course of its supervisory work in relation to AIs' selling of investment products. Details of issues and good practices identified that warrant further attention by AIs are set out in the Annex to the same (**Annex**).

22. Paragraph 3 of the Annex (**Paragraph 3**) sets out several issues identified by the HKMA in relation to the suitability assessment and selling practices of AIs. Issues critiqued include:

    (a) failures to properly consider a customer's investment horizon in conducting suitability assessments for investment funds;

    (b) unjustifiable conduct on the part of sales staff in soliciting/recommending customers to conduct highly frequent trading in investment funds; and

    (c) treating transactions which involved recommendation/solicitation as "execution-only"/ "unsolicited" transactions and not performing appropriate suitability assessments as required.

23. Paragraph 3 also highlights certain regulatory standards expected of AIs who sell investment products. This paragraph provides, among other things, that:

    (a) intermediaries should ensure the suitability of an investment recommendation or solicitation for a customer is reasonable in all the circumstances. They should at all times exercise their professional judgement to assess diligently whether the characteristics and risk exposures of each solicited/recommended investment product (including transaction costs) are suitable for the customer and are in the best interests of the customer, taking into account all the personal circumstances (including the customer's financial situation, investment experience, investment objectives, investment horizon, risk tolerance, etc);

    (b) in respect of recommendations or solicitations involving investment funds, in determining whether a fund is suitable for a customer, it should be noted that tenor mismatch may be relevant where the fund has specific tenor (e.g. guaranteed and structured funds where the issuers have provided capital guarantees and/or promised payouts to investors). Even for funds without a specific tenor, customer's investment horizon should also be one of the relevant factors that should be considered in the suitability assessment; and

    (c) For AIs which adopt the "unsolicited" transactions model, they should have proper policy, procedures and controls to ensure that such model will not be abused to circumvent their internal policy and/or regulatory requirements. These include clear guidance to relevant staff, effective review mechanism to test check compliance, appropriate MIS reports for senior management and relevant control units to help identify possible abuse by sales staff, and proper follow-up actions to address issues identified.

*Circular entitled "Findings of concurrent SFC-HKMA thematic review of spread charges and other practices" jointly issued by the SFC and the Hong Kong Monetary Authority on 29 October 2021 (**2021 Circular**)*

24. The 2021 Circular sets out a number of key observations noted from a concurrent thematic review of intermediaries' spread charges and related practices as well as their disclosure of transaction-related information.

25. Paragraph 4 of the 2021 Circular provides that if an intermediary is acting as an agent for its client in a transaction, it should not retain the benefits from price improvements[2]. If an intermediary is acting as a principal in a back-to-back transaction, the intermediary could retain the benefits, but it should disclose or agree this arrangement with its clients.

[2] As set out at paragraph 2 of the 2021 Circular, 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.

26. Paragraph 8 of the 2021 Circular also provides that intermediaries are expected to, among 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[3];

(b) ensure that any bilateral pricing arrangements are agreed with clients in writing[4];

(c) 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[5];

(d) clearly communicate internal policies and regulatory requirements to staff and provide them with appropriate training[6];

(e) implement pre-trade preventive controls and/ or post-trade detective controls to prevent or detect any deviations from the intermediary's policies and procedures[7]; and

(f) maintain proper records (including but not limited to provisions of the bilateral pricing arrangements) to demonstrate compliance with the requirements[8].

*Frequently Asked Questions (**FAQs**)*

27. On 30 September 2010, the SFC issued a set of FAQs regarding the requirement under paragraph 5.1A(b)(ii) of the Code of Conduct which states that:

"Q4: The term "acting in the best interests of the client" is open to interpretation. Would performance of steps including reminding the client of the risk mismatch of the product, documenting the reasons of any product recommendation as well as the reasons of the client's choice of the product, and obtaining the client's acknowledgement and confirmation of the risk mismatch be considered as acting in the best interests of the client?

[3] See paragraph 8(a).
[4] See paragraph 8(c).
[5] See paragraph 8(f).
[6] See paragraph 8(g).
[7] See paragraph 8(h).
[8] See paragraph 8(j).

A: *The Commission does not consider that taking certain pre-set steps in the selling process would amount to acting in the best interests of the client. Instead, intermediaries should assess whether the transaction is suitable for the client …*

If an intermediary is of the view that the transaction is not suitable for a client but then proceeds to effect the transaction for the client, the intermediary should be prepared to justify why, despite the unsuitability, the intermediary still considered it to be in the best interests of the client to do so."