



Key observations by the Hong Kong Monetary Authority

This annex shares key observations in relation to the thematic review of spread charges and other practices conducted by the Hong Kong Monetary Authority (HKMA) on registered institutions (RIs). The thematic review covered the selected RIs' policies, systems, controls and management supervision on distribution to clients of non-exchange-traded investment products (such as bonds and structured products).

Some control deficiencies and issues as well as examples of good practices revealed from the thematic review are set out below.

A. Internal control and management supervision over order handling and spread charges

Deficiencies and issues

Price improvement

1. Some RIs generally provided an indicative all-in price to the clients during order taking. In cases where price improvements occurred, the RIs represented that they could retain partially, or in full, the benefits of price improvements so long as the final spread charges were within the percentage ceiling of spread charges agreed with or disclosed to the clients. However, the RIs did not establish policies and procedures, controls and monitoring for management supervision or internal guidance to staff (e.g. on how the benefits arising from price improvements would be allocated and disclosed to clients).
2. An RI required its staff to indicate the intended spread in the system prior to trade, and such intended spread would be used for detecting any post-trade spread amendment. From the sample review, instances were noted where the staff member did not determine the actual intended spread prior to the trade, but only input a ball-park figure as the intended spread into the system for trade execution. The practice defeated the purpose of the intended spread information input into the system as audit trails for monitoring post-trade spread amendment.

Spread charges and pricing arrangements

3. Some RIs charged clients a spread higher than that disclosed to the clients in the standard fee schedules and/ or bilateral pricing agreements for transactions of bonds and structured products. The RIs did not put in place adequate controls and monitoring to ensure that the maximum limits of spread as set out in the standard fee schedules and the terms of the bilateral pricing agreements were properly adhered to.
4. Some RIs did not have clear and detailed guidance governing the establishment of bilateral pricing agreements for ensuring adequate disclosure of relevant material information was provided to clients (e.g. disclosure about the nature, scope of fees and terms of the agreements).

Examples of good practices

Price improvement

1. We noted that an RI required its staff to indicate the intended spread in the order management system prior to trade (for system-supported products) as audit trails and any subsequent changes in spread or other trade amendment were recorded in the system for monitoring purpose.
2. Some RIs established a dedicated committee or forum specifically to handle and provide management oversight on pricing and disclosure related matters. The dedicated committee or forum brought to senior management's attention any pricing related issues, and ensured the identified risks were mitigated in a timely manner.

Spread charges and pricing arrangements

3. An RI not only put in place pre-trade system controls (e.g. hard block on the maximum limit of spread) to prevent overcharging clients against the standard fee schedules and bilateral pricing agreements, but also conducted regular post-trade pricing review to identify any overcharging.

B. Disclosure of transaction-related information

Deficiencies and issues

Monetary benefits

1. Some RIs made a uniform disclosure of the maximum percentage of monetary benefits received or receivable from transactions of bonds and structured products by disseminating the standard fee schedules to clients at the account opening stage, on a regular basis or upon subsequent updates. However, we observed that:
 - Those RIs failed to disclose to their clients the monetary benefits received or receivable by the RIs on a transaction basis prior to or at the point of trade in some instances.
 - An RI merely made a uniform disclosure of the maximum percentage of monetary benefits to clients, but not a specific disclosure of the percentage ceiling (rounded up to the nearest whole percentage point) on a transaction basis as required under paragraph 8.3 of the Code of Conduct.
2. An RI received a recurring fee, as monetary benefits, from the product issuer based on the nominal amount of structured product and the client's holding period of the relevant product. Some instances were noted that the client-facing staff merely disclosed to the clients such monetary benefits receivable by the RI as a one-off fee, instead of a recurring fee.