

14 February 2018

Circular to licensed corporations on client facilitation

This circular sets out guidance on the standards of conduct and internal controls the Securities and Futures Commission (SFC) expects of licensed corporations (LCs) providing client facilitation services. It follows a thematic review¹ of selected LCs which assessed the effectiveness and adequacy of management supervision and controls in this area.

Typically, clients use facilitation services to obtain liquidity or achieve a guaranteed execution price. As the nature of the client relationship may change in a facilitation transaction due to the fact that LCs assume a risk-taking principal position rather than an agency position, conflicts of interest may arise.

The SFC emphasises that such conflicts of interest are a recurring regulatory concern. In 2014, the SFC held a Supervisory Briefing Session to draw the industry's attention to common deficiencies and vulnerabilities associated with client facilitation. More recently, a number of inconsistent practices were identified in routine inspections.

LCs are reminded that the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) requires that a licensed or registered person should act in the best interests of clients, disclose conflicts of interest and take all reasonable steps to ensure fair treatment of clients if conflicts of interest cannot be avoided².

The [Appendix](#) to this circular contains the SFC's detailed observations from the thematic review and highlights good industry practices for LCs to consider.

1. Controls, monitoring and management supervision

Sufficient management oversight should be in place to ensure that trade exceptions and other matters related to client facilitation are brought to management's attention for timely review.

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. These policies and procedures should be reviewed and updated on a regular basis.

Effective control functions should be established to properly manage the risks associated with client facilitation and to ensure adequate controls for detecting and addressing potential misconduct.

All relevant staff should be provided with periodic training on client facilitation as well as updates on internal policies and procedures.

¹ The thematic review was announced in the "[Circular to Licensed Corporations – SFC notifies the industry of review on best execution and client facilitation](#)" issued on 4 November 2016.

² General Principle 1, General Principle 6 and paragraph 10.1 of the Code of Conduct.



2. Segregation of agency and facilitation activities

To protect sensitive client information and avoid conflicts of interest, the physical work locations of agency and client facilitation traders should be segregated. The responsibilities of client facilitation traders should be clearly defined in mandates.

To prevent client facilitation traders from accessing agency order flows in trading systems, their user profiles and access rights should be granted according to their job responsibilities and subjected to periodic review.

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

3. 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 obtained³ so that they are fully aware of the inherent conflicts of interest.

The parties responsible for obtaining client consent should be clearly defined. Where either client-facing staff who handle client facilitation orders or the client facilitation desk are located in Hong Kong⁴, client consent is required.

4. Indications of interest (IOIs)⁵

IOIs should only be disseminated when they are based on a genuine client or proprietary intent to trade. IOIs should provide sufficient details⁶, and controls and monitoring should be implemented to ensure they are accurate and updated in a timely manner. Due care should be exercised when disseminating IOIs to reduce the likelihood of sensitive trade information being abused.

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

End

[SFO/IS/009/2018]

³ In cases where clients place a basket order, client consent can be obtained for the entire basket order and does not need to be obtained for each constituent stock.

⁴ In cases where LCs handle client facilitation orders placed by their affiliates on behalf of the affiliates' clients located outside Hong Kong, ie, the end clients, LCs can rely on their affiliates to obtain prior consent from the end clients. LCs should be able to demonstrate that they have exercised due care when relying on affiliates in obtaining client consent.

⁵ As a way to source potential clients with an interest in trading, LCs disseminate IOIs from time to time. It is common for client facilitation desks to disseminate IOIs due to the nature of their business. However, since IOIs are not only disseminated by client facilitation desks, this guidance should be applied across all trading desks.

⁶ For example, whether IOIs are underlined by agency orders, back-to-back transactions, a proprietary intent to trade or the unwinding of actual positions resulting from client facilitation trades.