



HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref: B1/15C
G16/1C

21 December 2018

The Chief Executives
All Registered Institutions

Dear Sir/Madam,

Misconduct Risks in Selling of Investment Funds

I am writing to draw your attention to misconduct risks in selling of investment funds, and to provide guidance on expected standards for prevention and management of such misconduct risks.

The Hong Kong Monetary Authority (HKMA) issued a circular on 8 April 2016 entitled “Feedback from recent reviews of the selling of investment products”, highlighting, among others, the malpractice of soliciting or recommending a customer to enter into highly frequent trading of investment funds which could hardly be justified, especially fund switching that makes little or no economic sense to the customer. Registered Institutions (RIs) are reminded to ensure that their investment recommendations or solicitations for customers are reasonable in all circumstances, and to act in the best interests of their customers.

Misconduct risks in relation to investment fund churning

Frequent subscriptions, redemptions and switching of funds may incur substantial commissions and/or other fees and charges, which may significantly undermine the customers’ investment returns. RIs should therefore ensure any solicitation or recommendation for fund subscriptions, redemptions and switching is suitable and in the best interest of the customer.

The HKMA expects RIs to follow the relevant regulatory requirements and the expected standards set out below to address the related misconduct risks, especially investment fund churning.

Regulatory requirements

RIs have to act with due skill, care and diligence and in the best interests of their customers¹, and to avoid conflicts of interest with customers. When conflicts of interest cannot be avoided, RIs should ensure that their customers are fairly treated². RIs should also ensure their recommendations or solicitations for customers are reasonable in all the circumstances³.

Expected standards

Management supervision

Senior management of RIs should assume full responsibility in ensuring that appropriate policies and procedures as well as systems and controls are in place, and that they work effectively to guard against any potential investment fund churning. Sufficient management oversight should be exercised to ensure that any red flags or issues identified are brought to management's attention for timely review and follow-up, and that effective remedial actions and enhancement measures are timely implemented.

Monitoring and review

RIs should carry out independent monitoring and review, and ensure that their monitoring and review mechanisms (including the scope and methodology) are effective for the purpose of identifying suspicious trading pattern of investment funds and potential investment fund churning activities.

Management Information System (MIS) reports should be properly designed such that suspicious trading patterns or potential churning transactions can be captured for further analysis and review. Parameters or thresholds used in generating the MIS reports should be reasonable and effective for the monitoring purpose.

Upon identification of any suspicious trading pattern and/or potential or actual investment fund churning activity, adequate and timely follow-up action(s) should be taken to remediate the issue; and report them to management for attention and review.

¹ General Principle 2 of the "Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission" (the "Code of Conduct").

² General Principle 6 of the Code of Conduct.

³ Paragraph 5.2 of the Code of Conduct.

Incentive systems and feedback mechanism

RIs should ensure that any sales targets are realistic, especially amidst the challenging business environment, and that sales targets on specific investment products should be avoided. Incentive systems should be properly structured to ensure non-financial performance of staff (e.g. compliance with legal and regulatory requirements as well as ethical standards, adherence to corporate values, and customer satisfaction) form a significant part of the overall staff performance measurement, and promote proper conduct and behaviour of staff. Clear and appropriate consequences for individuals engaging in any misconduct or undesirable/unacceptable behaviours should also be established and communicated to relevant staff.

Further, an effective feedback mechanism, including whistleblowing and escalation policy, should be in place to encourage timely reporting of any misconduct or malpractice identified by staff. At the same time, RIs should foster an environment that protects and supports their employees in reporting any misconduct or malpractice they observe.

Staff training

RIs should provide adequate and appropriate training to relevant staff, including front line and control functions, to ensure that they have adequate understanding of regulatory requirements and ethical standards concerning investment fund churning.

Besides, the training programme should aim to cultivate a sound culture within the RI, discourage misconduct and encourage internal reporting of misconduct by staff. It should also help sales staff properly assess the suitability of investment solicitations or recommendations to customers, including circumstances which should be duly considered (such as transaction costs, customers' investment objectives and funds' investment objectives, etc.)

RIs should review their policies, procedures, systems and controls, and make any necessary enhancement to ensure due compliance with the regulatory requirements and expected standards set out in this circular. The HKMA will continue to monitor RIs' selling practices and compliance with this circular as part of its on-going supervision.

Should you have any questions about this circular, please contact Mr Eric Mok at 2878-1405 or Ms Anita Chan at 2878-1538.

Yours faithfully,

Alan Au
Executive Director (Banking Conduct)

c.c. SFC (Attn: Ms Julia Leung, Deputy Chief Executive Officer and Executive Director (Intermediaries))