

**Bills Committee on Securities and Futures and Companies Legislation  
(Structured Products Amendment) Bill 2010**

**Regulatory Arrangements to Deal with Situations where  
an Intermediary has a Potential or Actual Conflict of Interest in Providing  
Services in relation to Investment Products**

**Purpose**

At the 16 December 2010 Bills Committee meeting, Members requested to have details of the existing regulatory arrangements adopted by the Securities and Futures Commission (“SFC”) and the Hong Kong Monetary Authority (“HKMA”) to deal with situations where an intermediary (including an authorized institution (“AI”)) has a potential or actual conflict of interest in providing services in relation to investment products, and be updated on the progress of the review of the arrangements. This paper responds to Members’ request.

**Arrangements on SFC’s licensees**

2. Regarding the intermediaries licensed by the SFC, the conflicts of interest issue is generally addressed by existing requirements in the Code of Conduct for Persons Licensed by or Registered with the SFC (“Code of Conduct”) which provide that -

- (a) an intermediary should try to avoid conflicts of interest, and when they cannot be avoided, should ensure that its clients are fairly treated; and
- (b) where an intermediary 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.

3. The Code of Conduct also provides that an intermediary should act in the best interests of its clients in providing services or recommending the services of an affiliated person to its clients.

4. Further, under the Securities and Futures (Contract Notes, Statements of Accounts and Receipts) Rules (Cap. 571Q), where an intermediary enters into a relevant contract with or on behalf of a client, it shall indicate in the contract note when it acts as principal.

5. The SFC has also conducted a review of the regulations governing sale of investment products to enhance investor protection. In May 2010, a set of measures, including measures to further mitigate conflicts of interest, were introduced. Distributors are required to disclose sales related information to investors prior to or at the point of sale which includes whether the distributor is acting as principal or agent, whether it is affiliated with the product issuer, and the benefits it receives from a product issuer for distributing investment products.

### **Arrangements on AIs**

6. AIs are required to follow the SFC's regulatory standards in their sale of securities or futures products. As a general principle, the Hong Kong Monetary Authority ("HKMA") has required AIs in their sale of investment products not regulated by the Securities and Futures Ordinance (including currency-linked, interest rate-linked as well as currency and interest rate-linked instruments) to follow similar standards.

7. The banking industry has adopted the following measures to address potential or actual conflicts of interest in the sale of investment products to customers where AIs act as principal in the transactions -

- (a) It is a usual practice among many AIs to act as principal in transactions with customers on a back-to-back basis. For back-to-back transactions, the AI's open positions arising from investment products sold to customers are fully covered through purchasing the same products from other counterparties which are usually financial institutions.

- (b) One of AIs' common measures to safeguard customers' interests for transactions in investment products is to seek quotations from several counterparties in addition to the AI's own dealing desk, and to select the offer (which may be from an external counterparty or the AI itself) with the best terms for customers.

8. As part of its day-to-day regulation, the HKMA reviews AIs' compliance with regulatory standards, including those on conflicts of interest, during on-site examinations.

**Financial Services and the Treasury Bureau  
Securities and Futures Commission  
Hong Kong Monetary Authority  
January 2011**