PRIVATE BANKING SALES AND ADVISORY PRACTICES

- OBSERVATIONS AND SUPERVISORY EXPECTATIONS FROM THEMATIC INSPECTIONS

INFORMATION PAPER

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1 EXECUTIVE SUMMARY

1.1 Singapore has established itself as one of the leading global private banking and wealth management centres. High-net-worth individuals and accredited investors choose Singapore because of its sound financial regulation and strong rule of law, amongst other factors. MAS expects financial institutions operating in the private banking industry in Singapore (referred to as "PBs" henceforth) to uphold high standards of market conduct and transparency in their dealings with clients, so as to safeguard clients' interests and Singapore's reputation as a leading wealth management hub.

1.2 MAS conducted thematic inspections on selected PBs to assess their sales and advisory practices in 2018 and 2019. The inspections focused on:

(a) **Governance** – management oversight of the sales and advisory activities, including the extent to which relevant issues were escalated and deliberated by senior management, clarity of roles and responsibilities, as well as the establishment of appropriate frameworks and controls.
(b) **Investment suitability** – frameworks and processes to ensure that clients receive appropriate financial advice and are recommended products that are suitable, taking into account their risk appetites and investment profiles.
(c) **Pricing controls and disclosures** – controls to promote transparency of fees[1] on transactions, including disclosures to and communication with clients, and processes to ensure that pricing arrangements agreed with clients are adhered to.
(d) **Culture and conduct** – staff's perceptions of front office culture, as well as tone-from-the top on organisational values and desired employee behaviour.

1.3 Recognising the importance of incentives in influencing behaviour, MAS also reviewed the **incentive structures**[2] of PBs that were not part of the thematic review on incentive structures in 2018. MAS has published an information paper on "Incentives Structures in the Banking Industry – Fostering Sound Behaviour and Conduct"[3] in 2019, highlighting positive industry practices and desired outcomes. MAS expects financial institutions to benchmark themselves against the desired outcomes set out in the paper, and take steps in a risk-appropriate manner to address gaps, if any.

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[1] Include charges and other quantifiable benefits such as rebates, commissions, retrocessions and spreads received or charged by a financial institution.

[2] Including frameworks and processes for performance evaluation, remuneration and compensation, as well as disciplinary actions and consequence management.

[3] https://www.mas.gov.sg/publications/monographs-or-information-paper/2019/incentive-structures-in-the-banking-industry-fostering-sound-behaviour-and-conduct

1.4 From the thematic inspections, MAS observed that PBs have largely adopted the investment suitability and pricing disclosure standards set out in the Private Banking Code of Conduct (PB Code)[4] and Guidance on Private Banking Controls[5]. Some PBs have established good practices with regard to investment suitability and pricing checks that others can emulate. Others have room to improve the rigor of control processes and effectiveness of implementation. As the inspections were conducted on selected PBs, the observations reflected in this paper may not be representative of the full range of industry practices. The intent of this paper is to share observations so that financial institutions can draw reference and elevate standards where relevant.

1.5 On **investment suitability**, PBs generally have relevant controls in place, although there was room to improve the effectiveness of surveillance checks, as well as the product coverage of these checks, to mitigate the risks of inappropriate advice and sales of products to clients. MAS expects PBs to update clients' risk profiles and financial needs regularly, and implement adequate checks to identify mismatches between product features and clients' risk profiles on a pre-trade basis and through timely post-trade surveillance checks. MAS also encourages PBs that are assessing investment suitability at the product and transaction level, to complement these with assessments at the client's portfolio level. This is to provide a more holistic approach towards assessing the appropriateness of clients' investment portfolios vis-à-vis their investment objectives and risk appetites. In addition, MAS noted a few front office staff[6] who attempted to steer clients towards higher risk profiles so that they could be availed to riskier products, and alluded to risk profiling as a "paper exercise". There were also instances where post-trade follow-ups by front office on clients' portfolio investment suitability mismatches were inadequate and untimely. Such observations pointed to front offices' lack of appreciation of the underlying intent of these controls, and adopting a perfunctory approach towards these checks. MAS expects PBs to inculcate the right mind set and understanding amongst front office staff with regard to clients' safeguards and their duty to act in their clients' interests.

1.6 On **pricing controls and disclosures**, MAS noted varying standards of controls amongst PBs. Some PBs have implemented pre-trade system-enabled controls to prevent over-charging of clients on an ex ante basis, while others lacked holistic governance frameworks and controls to ensure that fee schedules or bilateral pricing arrangements agreed with clients were adhered to. Due to the lack of comprehensive controls, MAS noted some instances where clients were charged more than that agreed in fee schedules

[4] https://www.abs.org.sg/docs/library/pb-code-of-conduct-14-feb-2020.pdf

[5] https://www.mas.gov.sg/publications/monographs-or-information-paper/2014/guidance-on-private-banking-controls

[6] Including Relationship Managers and Assistant Relationship Managers with client-facing roles.

or bilateral pricing arrangements. There were also instances where price improvements arising from client transactions[7], and how such benefits from price improvements were allocated, were not disclosed to clients. MAS would like PBs to pay attention to the following observations:

(a) Management attention on pricing matters
One of the root causes of control lapses leading to over-charging of clients in a few PBs was the lack of management attention and emphasis on pricing issues. Controls relating to pricing were not prioritised for discussion, and requests for system enhancements to facilitate adherence to pricing arrangements were not raised for management's consideration and not implemented. Pricing exceptions such as unauthorised deviations from agreed pricing arrangements identified from post-trade surveillance checks were not escalated and reported regularly at management committees. In some PBs, such information were tabled at management forums, but there were no in-depth deliberation or root cause analysis, resulting in missed opportunities to improve controls to prevent recurring cases of over-charging.

(b) Awareness of front office staff
A few PBs have explained that some clients were over-charged due to front offices' oversight or negligence. Besides Relationship Managers (RMs), instances where Assistant Relationship Managers (ARMs) with client-facing roles had miscommunicated fees and charges to clients were noted. As RMs and ARMs form the first line of defence, they play a key role in communicating and providing clear disclosures to clients. PBs should promote awareness amongst RMs and ARMs, so that they appreciate the importance of transparency and acting in clients' interests, including ensuring clients understand what they are being charged.

(c) Change management and post-implementation reviews
The importance of robust change management cannot be understated as banks undergo multiple system changes and software upgrades on a business-as-usual basis. Such changes, if not well managed, could result in data integrity issues and design flaws that could inadvertently lead to over-charging of clients. PBs should establish robust change management and post-implementation reviews to determine the impact of such changes, identify unintended implications and consequences that need to be rectified, and ensure systems and processes are working as intended.

[7] Price improvements happen when a PB executes a trade at a price better than that quoted to the client during order taking. This means that if the PB is buying (selling) a product on behalf of the client, it manages to buy (sell) it at a lower (higher) price than that quoted to the client with a spread. The PB either retains the benefit from price improvements, or passes the benefit to the client partially or in full.

(d) Accountability over pricing issues
Accountability and responsibility over pricing issues, oversight of a product's life cycle, as well as product ownership, were not clear or well-articulated. PBs should establish clear roles and responsibilities across the three lines of defence, including accountability for ensuring that pricing arrangements are adhered to.

(e) Use of technology and data analytics
Where system-enforced pre-trade controls to identify deviations from agreed pricing arrangements are not feasible, PBs typically implement post-trade surveillance checks as an ex post mitigating control. These checks are performed by a business control function[8] or independent units such as Compliance or Operations. MAS noted that many post-trade checks involve highly manual processes that necessitate extensive use of spreadsheets and manual manipulation of data. This makes such checks labour-intensive, time-consuming, and highly susceptible to human errors. MAS encourages PBs to explore the use of technology and data analytics to automate and process data in a more efficient way that will reduce errors and ease resource constraints.

1.7 MAS takes PBs' obligations to safeguard clients' interests seriously. We look to the PBs' Board and senior management to exercise oversight of governance frameworks and effectiveness of policies and processes over the sales and advisory practices, including controls and systems to safeguard clients' interests and ensure that pricing arrangements and disclosures to clients are honoured. We expect PBs to:

(a) Accord adequate management attention and emphasis on pricing issues, including raising awareness amongst front office and control functions.
(b) Establish comprehensive governance frameworks and controls, across the three lines of defence, to ensure that pricing arrangements and disclosures to clients are honoured.
(c) Communicate and agree with clients, the fees, charges and any other quantifiable benefits in a timely and transparent way. This means that clients understand, in a clear and unambiguous manner, how they are charged for their transactions.
(d) Implement effective controls to ensure that fee schedules or bilateral pricing arrangements agreed with clients are adhered to. Any deviations from these pricing arrangements, including updates and revisions, should be disclosed and agreed with clients in a timely manner.
(e) Disclose and agree with clients how benefits from price improvements arising from client transactions[7] should be allocated, and establish controls to adhere to such arrangements. PBs are not prohibited from retaining benefits from price

[8] Some PBs refer to the business control function or unit as the 1.5 line of defence. This function is separate from front office, but reports into the Business Head.

improvements as long as the arrangement is transparent to clients and they have a clear understanding of what they are being charged for their transactions. Clients should not be misled into thinking that the PB is passing all benefits from price improvements to them, when it is not doing so.

1.8 Where instances of over-charging[9] were uncovered during inspections, PBs have contacted and refunded clients, or are in the process of doing so. As MAS' inspections were conducted on a sampling basis to test and check control processes, MAS has instructed relevant PBs to perform a more thorough review of their transactions to ascertain whether there were other instances where clients were over-charged. MAS will continue to engage PBs as part of our on-going supervision and will take appropriate actions where PBs are found to have breached our regulations.

1.9 MAS recognises that frameworks and controls can only go so far to shape the behaviour of PB staff, particularly those who have profit and revenue targets[10]. The culture, shared values and norms of the PB are equally, if not more, important drivers of behaviour. As part of the thematic inspections, MAS held several conversations with front office and control functions to obtain their perceptions of the PBs' culture and values. We identified recurring themes arising from these conversations as well as areas for attention, and reflected these observations back to PBs' management as a form of feedback. These conversations were conducted in confidence, with no attribution of either comments or observations to specific individuals. We have also requested PBs and their management to respect the confidentiality of these conversations and refrain from investigating the comments made by staff MAS spoke with. PBs should pay attention to observations that apply to some front office staff below:

(a) Front office lacked clarity on the key performance indicators (KPIs) that they were measured against, particularly non-financial or behavioural targets, the weightage between financial and non-financial targets, and their impact on performance evaluation and remuneration.
(b) The pressure on front office to grow the business and achieve targets was evident in a few PBs, partly attributable to a sales-focused and competitive culture, and an appraisal system that benchmarked RMs against their peers.
(c) Front office did not have strong recollection of messages from senior management. They could remember organisational values, but were unable to articulate how these values translated into behavioural expectations and what these meant to their specific roles on a day-to-day basis.

[9] Refer to Annex A for examples of scenarios of over-charging.
[10] Such staff include RMs or private bankers and their assistants, as well as product specialists or advisors.

(d) Front office did not have a good appreciation and understanding of the intent and purpose of certain controls, perceiving them as overly burdensome, too "administrative" or "prescriptive".
(e) Some PBs focused mainly on the use of demerit points and penalties to discourage misconduct, with less emphasis on influencing behaviour through other means such as recognition and celebration of exemplary conduct and role modelling.

1.10 MAS looks to the PBs' Board and senior management to foster a culture of good conduct and high ethical standards, by setting a strong tone-from-the-top on the importance of treating clients fairly and safeguarding clients' interests. In particular, MAS expects the Board and senior management to:

(a) Foster a culture of good conduct by setting a strong tone-from-the-top on the PB's core values and code of conduct.
(b) Communicate KPIs against which staff are appraised in performance evaluation and remuneration frameworks clearly. These KPIs should adequately consider behavioural and conduct factors, in addition to financial KPIs.
(c) Ensure that the pressure on front office to achieve business targets does not come at the expense of high ethical standards, prudent risk management and prioritisation of clients' interests.
(d) Exemplify organisational values and desired conduct by "walking the talk" or role-modelling.
(e) Set clear boundaries of desirable and unacceptable behaviour, and improve the frequency and clarity of tone-from-the-top with respect to issues relating to the sales and advisory process, including the need to be transparent with clients on pricing issues.
(f) Convey the consequences of unacceptable behaviour and share lessons learnt from past misconduct cases, industry developments, as well as case studies of moral dilemmas.
(g) Give due recognition and celebrate exemplary behaviour – use "carrot" in addition to "stick".
(h) Be mindful of sub-cultures, as they could undermine cohesion and teamwork, and impede achievement of organisational goals. PBs that are expanding rapidly through acquisitions or new hires should be particularly cognisant and alert to this.

1.11 MAS expects financial institutions operating in the private banking industry in Singapore to benchmark themselves against the practices and supervisory expectations set out in this paper. PBs should assess the ability of their internal controls and processes to meet the expectations effectively. Where there are gaps, PBs should address them in a manner appropriate for their context, taking into account their business models and risk profiles. Banks that provide sales and advisory services to other affluent client segments, such as premier and priority banking, should apply learning points from this paper to these businesses where relevant. MAS will engage banks as part of our on-going supervision, and take relevant observations into account in our supervisory assessments.

1.12 If you have any clarifications or feedback on this paper, please provide your comments to the Inspection and Supervisory Methodologies Department at MAS_IMD@mas.gov.sg.

2 OBSERVATIONS FROM THEMATIC INSPECTIONS

2.1 MAS' inspection approach included the review of frameworks, policies and processes, conduct of walkthroughs and discussions with management and staff, and sampling of investment transactions and disclosures. MAS also benchmarked practices amongst the PBs included in the thematic exercise.

2.2 The inspections were complemented by conversations with the PBs' staff, on their perceptions of the PBs' culture and tone-from-the-top[11]. These conversations provided insights on how culture and tone-from-the-top influenced front offices' behaviour in the sales and advisory process.

2.3 MAS' observations and supervisory expectations are set out under the following themes:

(a) Governance
(b) Investment suitability
(c) Pricing controls and disclosures
(d) Culture and conduct

2.4 Boxes 1 to 6 summarise the key takeaways of each section to facilitate self-assessments by financial institutions, in particular those that were not included in this thematic exercise.

[11] MAS held conversations with senior management, sales and advisory staff, as well as staff from control functions.

3 GOVERNANCE

3.1 Board and senior management (BSM) set the overall business and risk management strategies that determine the sales and advisory practices of the PB. BSM should exercise oversight over the establishment of frameworks, policies and processes to promote fair dealing with clients and mitigate conduct risks[12].

3.2 ***Management oversight*** – PBs generally have frameworks and processes to facilitate management's monitoring of sales and advisory activities. Most PBs deliberate matters pertaining to sales and advisory, such as investment suitability, pricing decisions and conduct risks, at monthly management committee meetings and other forums such as pricing or product committee meetings. Most PBs also have processes to monitor and report key performance and risk indicators to management, including sales of higher risk products, number and nature of client complaints, timely completion of suitability reviews and staff's compliance with policies and procedures. However, the management of a few PBs did not pay adequate attention to the implementation of controls to monitor and follow up on unauthorised deviations from fee schedules and bilaterally agreed pricing arrangements with clients. They did not notice omissions in the reporting of pricing-related key risk indicators, and had not requested root-cause analyses or trend analyses when instances of over-charging were uncovered during post-trade surveillance reviews. In one instance, pricing control gaps identified by Internal Audit were not discussed at management committees and were not addressed for more than two years. Consequently, instances of over-charging were identified during MAS' inspections. These observations were indicative of inadequate management attention and oversight in governing pricing controls and disclosures. We expect BSM to pay adequate attention to pricing issues, including raising risk awareness amongst front office and control functions.

3.3 ***Control functions and processes*** – Most PBs have established dedicated sales surveillance or business control functions[8] to monitor and check the sales and advisory activities on an on-going basis[13]. Such business control functions could be a separate unit within the business (part of first line of defence), or an independent unit within the risk or operations functions (part of second line of defence). Most PBs also have compliance functions that, as part of compliance testing, periodically review the coverage and quality of checks conducted by the business control functions. The business control and compliance functions typically have processes to report observations on non-compliance

[12] The risk of inappropriate, unethical or unlawful behaviour on the part of an organisation's management or employees.

[13] Refer to paragraphs 4.3, 4.4 and 5.5 for a description of the types of checks and surveillance.

with policies and procedures[14], as well as identified control gaps, to management. Most PBs have processes to support pre- and post-trade checks to mitigate the risk of selling inappropriate products. Some PBs did not have systems that trigger alerts or block trades from being executed if deviations from fee schedules and bilateral pricing arrangements were detected. Many PBs have post-trade surveillance checks that were highly manual and subject to human errors, resulting in incomplete or erroneous reports. PBs are expected to establish robust controls and systems that commensurate with the scale of their businesses. Checks performed by the first and second lines of defence should be effective in identifying and following up on exceptions, including over-charging of clients. PBs should also consider incorporating instances of over-charging within front offices' balance scorecard to drive the right behaviour.

3.4 ***Records of communication with clients*** - For the purpose of maintaining proper audit trails, most PBs require RMs to accept clients' trade instructions only on official recorded telephone lines or other approved recorded communication channels. A few PBs did not have similar requirements. The maintenance of voice logs is critical to facilitate post-trade checks by the business control and compliance functions, as well as the investigation of complaints or disputes. MAS expects trade instructions from clients to be taken via approved channels, such as recorded telephone lines, for proper audit trail and record maintenance. Such records should be retained for an appropriate period[15].

[14] Such reports typically include statistics and details on (i) whether clients' transactions/portfolios were appropriate for their given risk profiles, (ii) whether there were exceptions identified in post-trade surveillance checks , and (iii) whether there were instances of incorrect client charging. PB staff are required to follow up and address such exceptions.

[15] MAS' consultation paper on "Controls against Market Abuse" proposes that financial institutions keep records of communication on orders and trades for at least 5 years: https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Consultation-Papers/05082019-Control-Against-Market-Abuse/Consultation-Paper-on-Requirements-on-Controls-Against-Market-Abuse.pdf

Box 1 – Governance and oversight by BSM

Board and senior management:

- Exercise oversight of frameworks, policies, processes and systems across the three lines of defence to gain assurance that sales and advisory activities are conducted in a manner that is ethical, prudent and in the clients' best interests.
- Establish clear accountability and responsibility over sales and advisory activities, including pricing issues and oversight of a product's life cycle.
- Accord adequate attention and emphasis on pricing issues, including raising awareness amongst front office and control functions.

4 INVESTMENT SUITABILITY

4.1 PBs and their RMs should act in the best interests of clients when providing financial advice and recommending financial products. To this end, RMs should understand clients' risk profiles and financial needs, and exercise due care and diligence to consider these when making financial recommendations. Client profiles and financial needs should be documented adequately, reviewed periodically and updated when clients' circumstances change. PBs should implement controls to safeguard clients against inappropriate sales practices and mis-selling of unsuitable products by RMs.

4.2 ***Client risk profiles*** – All PBs require clients to complete a risk assessment questionnaire at the time of on-boarding. This allows PBs to understand and assess clients' risk profiles and financial needs. Examples of factors considered in a client risk assessment questionnaire are:

(a) Investment objectives
(b) Investment horizon
(c) Loss and volatility tolerance
(d) Financial needs or constraints from liquidity requirements
(e) Investment experience and product knowledge
(f) Risk tolerance on the use of leverage

4.2.1 *Documentation of clients' risk profiles* – All PBs require clients' profiles to be supported by properly completed client risk assessment questionnaires and other relevant documents. The outcome of the client risk profiling process is typically a client risk rating[16], which in turn determines the products that could be recommended to or traded by the client. To safeguard against unauthorised amendments to completed client risk assessment questionnaires, most PBs provide clients with a copy of the completed questionnaire and the finalised risk profile. This is done at on-boarding and whenever there are updates to the clients' circumstances. A few PBs also have the good practice of requiring clients to acknowledge their assigned risk profiles before commencement of order taking.

4.2.2 *Updates to clients' risk profiles* – PBs usually require clients' profiles to be updated at least biennially, and whenever there are changes to the clients' circumstances. Where PBs are unable to update a client's risk profile on time, some PBs have established safeguards to mitigate the risks of recommending unsuitable products to clients in the interim. These interim safeguards include re-classifying the client to a more conservative risk profile, hence limiting the sales of high-risk products to the client, or permitting the

[16] The client risk rating is an indication of how conservative or aggressive a client is in terms of investing.

client to execute only "sell" transactions until the profile has been updated. PBs that do not have controls to manage the risks of dealing with clients with outdated profiles should consider adopting these good practices.

4.2.3 *Overrides to clients' risk profiles*[17] – Overriding of clients' risk profiles, especially to more aggressive risk profiles, should be accompanied by proper justifications and approvals. MAS observed instances where overriding of clients' risk profiles were inappropriately approved with justifications that were inadequate or invalid. There were also instances where RMs had unduly influenced clients' responses to the risk assessment questionnaire by inappropriately steering them towards higher risk profiles, so as to allow the sales of riskier products to these clients. Instances were also noted where clients were told by their RMs that the risk profiling exercise was a paper exercise. These observations reflect RMs' lack of risk consciousness and adopting a perfunctory approach towards the risk profiling exercise. MAS expects PBs to inculcate the right mindset and understanding amongst front office staff with regard to clients' safeguards and their duty to act in the interest of their clients. PBs should pay attention to changes in clients' profiles and implement controls to mitigate the risk of clients being unduly influenced to take on higher risk profiles or invest in products beyond their intended risk appetites. Examples of such controls include regular analyses of migration of clients' profiles to identify unusual trends and patterns, and performance of independent sampling checks (e.g. listening to voice logs) to assess whether RMs inappropriately influenced clients to adopt a higher risk tolerance.

4.2.4 *Vulnerable clients (VCs)* – Most PBs require RMs to identify clients who display traits of vulnerability and assess if they are VCs[18]. This is performed at the time of client on-boarding and during periodic client reviews. As a good control, some PBs restrict potential VCs from transacting until the assessment is completed and approved. Most PBs adopt safeguards for VCs, such as offering them third-party companionship - a companion of the VC's choice or another PB staff - during order taking, assigning them to more conservative risk profiles, restricting their investments in risky or complex products, and requiring RMs' supervisors to perform call-backs to confirm that the VC understands the investment risks of a transaction[19] before execution. Most PBs allow clients to opt out of being classified as VCs and the corresponding safeguards, with the approval of the RMs' supervisors. A few PBs' practices were not in line with industry standards as they did not

[17] Overrides to clients' risk profiles refer to manual adjustments to the risk profiles or client risk ratings derived from the client risk assessment questionnaires.

[18] Examples of traits include a client's education level, proficiency in written or spoken English, changes in sources of income, age, illness, physical or intellectual disabilities, and ability to make independent investment decisions. The determination of VCs is usually based on a client's circumstances holistically, instead of any single factor.

[19] This usually applies when the VC has limited knowledge of financial products or when the VC is purchasing a complex product.

have systematic processes to assess and identify VCs. Notwithstanding that PB clients are high-net-worth individuals, as VCs are more susceptible to financial exploitation and mis-selling, MAS expects PBs to have in place robust processes to identify such clients and accord them the necessary safeguards.

Box 2 – Client risk profiles

Banks establish frameworks and processes to adequately assess, update and document clients' risk profiles and financial needs on a timely basis.

For clients with outdated risk profiles, banks implement safeguards to mitigate the risks of recommending unsuitable products to these clients.

Banks raise awareness amongst front office staff so that they understand and appreciate the underlying intent of controls (including client risk profiling and investment suitability checks), and do not inappropriately influence clients to take on more aggressive risk profiles or invest in products beyond their risk appetites.

Banks establish policies and processes to identify VCs, both at the time of client on-boarding and periodically, and offer VCs additional safeguards.

4.3 ***Pre-trade investment suitability checks*** – Prior to executing trades for clients, all PBs require RMs to disclose key product features such as product name, price, currency, quantity, order type (market or limit order[20]) to clients. RMs are also required to highlight any investment suitability mismatches between product features and the client's risk profile and financial needs.

4.3.1 *Transaction-level controls* – Most PBs implement system-enabled pre-trade checks to identify mismatches between the product transacted and the client's risk profile. Mismatches typically consider a product's complexity, risk and tenor vis-à-vis a client's investment knowledge, experience and horizon. Some PBs also identify large transactions[21], transactions resulting in product concentration in the client's portfolio[22],

[20] Market orders are clients' instructions to execute a trade at the prevailing market price. Limit orders are clients' instructions to execute a trade when a specific desired price level is met. If the desired price level is not met, the order will not be executed. A limit order guarantees a price, but does not guarantee an execution. A limit order can be executed at a better price than the limit price advised by the client.

[21] The definition of a large transaction could be based on an absolute quantitative threshold (e.g. USD 10 million) or a certain percentage of a client's liquid net worth.

[22] An example is where the total exposure resulting from a client's new position plus his/her existing exposure from the same underlying asset type exceeds a concentration risk threshold set by the PB for the asset type.

use of leverage by clients, trades involving unapproved products[23], and trades that are inconsistent with house views[24] for further follow-up and due diligence. The system-enabled checks usually include prompts to remind RMs to document reasons for proceeding with these trades and disclose specific risks to clients before transacting. A few PBs did not have sufficiently robust system-enabled pre-trade controls that adequately covered relevant products and risk areas. Their systems were not sufficiently comprehensive to cover the suitability criteria set out in their policies, such as product mismatches and tenor mismatches. These PBs also did not supplement the gaps in their system-enabled controls with mitigating controls, such as post-trade checks and surveillance. Where pre-trade system checks are absent, MAS expects PBs to implement post-trade checks and surveillance to detect and follow up on exceptions.

4.3.2 *Portfolio-level controls* – Many PBs have implemented, or are implementing, frameworks and systems to monitor clients' investments at the portfolio-level. This complements the product suitability checks on a trade-by-trade basis mentioned in the paragraph above. This also facilitates a more holistic approach towards assessing the appropriateness of clients' investment portfolios vis-à-vis their investment objectives and risk appetites. To ensure that the methodology underlying the portfolio-level monitoring approach remains fit for purpose over time, these PBs subject these models to regular independent validation. MAS encourages all PBs to consider developing a portfolio-level monitoring approach, to complement transaction-level monitoring of investment suitability mismatches, for a more holistic review of clients' overall investment portfolios.

4.3.3 *Unsolicited transactions* – All PBs maintain an approved list of products that RMs could recommend to their clients. Most PBs prohibit RMs from recommending any unapproved products[22] or products that are inconsistent with the PBs' house views[23]. RMs can only buy or sell such products for clients if the transaction is client-initiated and not solicited by the PB. In such cases, RMs are required to inform clients that the products are not on the PB's approved list or that the trade is inconsistent with the house view. Some PBs also require RMs to seek approvals from the product team before executing such transactions. Several PBs, however, did not tag client-initiated trades as such in their trade order systems, hindering the identification of such trades for effective monitoring. In addition, only some PBs implemented the good practice of informing clients when previously approved products, which the clients had bought, were removed from the approved list or had deteriorated in terms of product rating.

[23] These refer to products that are not formally assessed, risk-rated, subjected to due diligence and approved by the PB for recommendation to clients.

[24] For example, a "buy" transaction initiated by a client on a product with a "sell" rating by the PB's research team.

Box 3 – Pre-trade investment suitability checks

Banks implement investment suitability checks to identify mismatches between product features and clients' risk profiles on a pre-trade basis, or through timely post-trade surveillance checks.

Banks develop a portfolio-level monitoring approach, to complement transaction-level monitoring of investment suitability mismatches, to facilitate a more holistic assessment of the appropriateness of clients' portfolios vis-à-vis their investment objectives and risk appetites.

Banks exercise oversight of products recommended and sold to clients, in particular unapproved products and products inconsistent with house views.

4.4 ***Post-trade surveillance*** – All PBs conduct post-trade checks and surveillance regularly to identify inappropriate sales practices and investment suitability mismatches for timely remediation. Post-trade surveillance typically entails review of samples of client transactions/portfolios to assess whether product recommendations were appropriate for clients given their risk profiles, and whether investment suitability mismatches have been communicated to and acknowledged by clients. Remedial actions for transaction-level mismatches include providing proper disclosures to clients, obtaining clients' acknowledgement for the mismatch and maintaining documentation of these communications. For portfolio-level mismatches, PBs could request clients to (i) inject more cash to adjust the asset allocation in their portfolios so as to reduce the portfolio risk rating, (ii) update clients' risk profiles if their circumstances have changed, (iii) re-balance investment portfolios by selling higher risk-rated products and buying lower risk-rated products, or (iv) accept the mismatches and take no action following discussions with clients. Post-trade controls are typically performed by business control units[8], which also tracks the progress of RMs' remedial actions. The compliance function also conducts compliance testing to independently assess the quality and effectiveness of the checks performed by the business control units. Such compliance testing is important, in view of the lapses in surveillance checks conducted by business control units noted from the inspections.

4.4.1 *Coverage and sampling methodology by business control units* – The coverage of post-trade checks and sampling methodology used by the business control units required improvement in general. Some PBs did not include all relevant transactions within scope for sample selection, while others did not include all RMs at least once within the annual cycle of sample checks[25], or include RMs with past control lapses for further sample checks.

4.4.2 *Compliance testing* – A typical compliance testing programme involves checks relating to the handling of investment suitability mismatches (whether there are adequate disclosures to clients and whether mismatches are promptly remediated), periodic reviews to detect inappropriate sales practices and instances of mis-selling, as well as sample checks on the effectiveness of the surveillance conducted by the business control unit. The scope and frequency of compliance testing required enhancements in some PBs. For example, the compliance testing programme did not include investment suitability, or covered this area only on a limited basis (where certain product types and mismatch typologies were omitted from testing) and infrequently (the compliance testing frequency ranges from annually to within an eight-year cycle). MAS expects PBs to regularly include investment suitability in their compliance testing, and to report significant issues noted to management.

Box 4 – Post-trade surveillance

Banks conduct post-trade checks and surveillance to identify inappropriate sales practices and investment suitability mismatches for timely remediation.

Banks conduct adequate and regular testing of investment suitability controls by a unit independent of front office.

[25] Without including all RMs at least once within the annual cycle of sample checks, the results of the sample checks may not be representative of the population of RMs' transactions.

5 PRICING CONTROLS AND DISCLOSURES

5.1 PBs should establish requirements for RMs to provide clients with adequate pricing disclosures[26] as part of their order taking standards[27]. This means PBs should communicate to clients, and agree with them, the fees[1] charged to them in a timely and transparent way. Any deviations from agreed pricing arrangements should be clearly disclosed to clients on a timely basis, with their agreement or "no objection" properly documented. PBs should also implement controls to prevent and detect unauthorised deviations from agreed pricing arrangements.

5.2 ***Fee schedules*** – All PBs provide clients with standard fee schedules at the time of account opening or prior to the client's first order taking. The standard fee schedule sets out the range of fees a PB would charge for all categories of investment products and services. Some fee schedules lacked details and were not sufficiently comprehensive by omitting certain products, particularly structured products. Most PBs require RMs to inform clients, and obtain their agreement, on a pre-trade basis if prices exceed the fee schedules. Most PBs also implement controls to monitor deviations from fee schedules, although in most cases, the range of products covered as part of these monitoring controls was incomplete. In addition, not all PBs had adequate policies to inform clients of changes to fee schedules on a timely basis. As a result, the inspections noted instances where clients were charged fees above those stated in the fee schedules.

5.3 ***Bilaterally agreed pricing arrangements*** – RMs may have bilateral pricing arrangements agreed with clients that deviate from the standard fee schedules. Such arrangements, usually regarding discounts on standard fee schedules, ranged from formal standing agreements to verbally agreed one-off deals. RMs are expected to disclose to clients, and obtain their agreement, on a pre-trade basis if RMs deviate from bilaterally agreed pricing arrangements. The inspections revealed that PBs need to improve their governance and control processes over bilateral pricing arrangements agreed with clients. Due to control deficiencies, MAS' inspections uncovered clients with such arrangements who were charged fees above what was agreed.

5.3.1 *Standing arrangements* – A few PBs have governance frameworks and controls to manage and ensure adherence to standing bilateral pricing arrangements agreed with

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[26] This includes disclosures of (i) all sales charges and other quantifiable benefits, (ii) capacity (principal or agent) in which a PB is acting, (iii) any actual/perceived conflicts of interest in dealing with product issues or affiliates, (iv) key risks associated with the transaction such as those associated with leverage and margin financing, and (v) termination clauses.

[27] Order taking standards include setting out the mandatory information on the transaction to be communicated to clients, such as product name and features, currency, price, quantity, and order type (i.e. market or limit order).

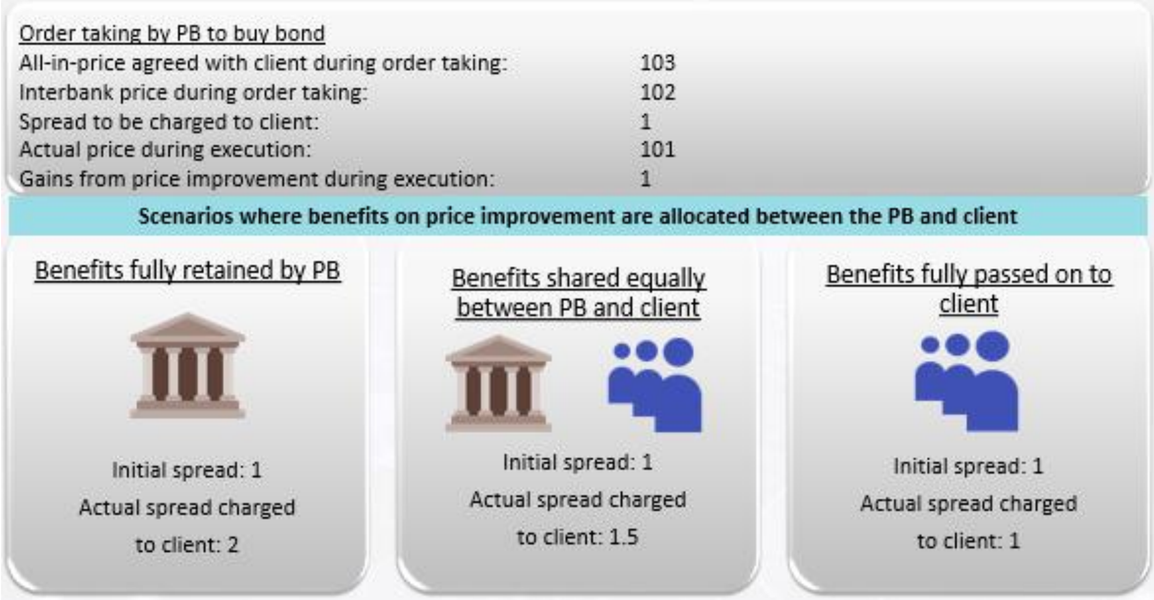
clients. These PBs have implemented approval authorities and system workflows to approve and centrally maintain documentation of such arrangements. They also implement system-enforced controls to detect deviations from agreed pricing arrangements. Other PBs did not have frameworks and processes to manage such arrangements. There were no records or documentation of such arrangements, and no processes to systematically monitor and detect deviations from these arrangements. In some PBs, system-enforced controls covered only a limited scope of products.

5.3.2 *One-off arrangements* – These arrangements include clients' limit orders and orders where RMs had promised clients a specified or better price. A few PBs require RMs to seek approval for, and centrally record, such one-off arrangements through a system workflow. Most PBs had left RMs to manage such one-off arrangements on their own and relied only on voice logs for records.

5.4 ***Benefits from price improvements*** – Some products, such as bonds and structured notes, are traded over-the-counter or in interbank markets. Prices for such products may not be widely available. At the time of order taking, RMs usually communicate to clients an indicative price for the trade. Depending on market factors at the point of executing the trade, the price could improve or deteriorate relative to the indicative price quoted to the client. Price improvements happen when a PB executes a trade at a price better than that quoted to the client during order taking. This means that if the PB is buying (selling) a product on behalf of the client, it manages to buy (sell) it at a lower (higher) price than that quoted to the client with a spread. The PB either retains the benefit from price improvements, or passes the benefit to the client partially or in full.

5.4.1 *Disclosure and allocation of benefits from price improvements* – Some PBs did not have transparent practices relating to the disclosure of allocation of benefits from price improvements. Benefits could be fully passed on to the client, fully retained by the PB, or shared between the client and the PB. This is illustrated in Figure 1 below. In some cases, the full or partial retention of benefits from price improvements by PBs resulted in the total price charged to clients exceeding the fee schedules or bilaterally agreed pricing agreements.

Figure 1 – Example of how benefits from price improvements can be allocated



5.4.2 MAS' inspections noted a lack of transparency around the disclosure and allocation of benefits from price improvements. Instances were noted where front office agreed with clients to charge a specific spread, but clients were not aware that they were in effect charged more than the agreed spread when the PB executed the trade at a more favourable price without passing any benefit from the price improvement to clients. In other instances, PBs did not pass any benefit from price improvements to clients as committed during order taking[28]. PBs are not prohibited from retaining benefits from price improvements. MAS advocates transparent, clear and unambiguous disclosure and understanding by clients of what they are charged. Clients should not be misled into thinking that benefits from price improvements have been passed on to them when the PB did not do so. PBs should inform clients of any price improvements, and disclose and agree on how these should be allocated between the PB and the client. Such disclosure and agreement should be properly documented to facilitate any pre- and post-trade checks.

5.5 ***Controls to ensure adherence to pricing arrangements*** – Some PBs did not have systematic and comprehensive policies and frameworks to prevent and detect over-charging of clients above agreed fee schedules or bilateral pricing arrangements. Others have a combination of system-enforced and other monitoring controls to detect over-charging, but these were not sufficiently comprehensive as certain products and transactions were omitted without good justifications.

[28] Refer to Annex A for specific examples.

5.5.1 *Pre-trade controls* – A few PBs have implemented system-enforced pre-trade controls to trigger alerts or blocks, when transactions with deviations from fee schedules and/or standing bilaterally agreed pricing arrangements are detected. These alerts or blocks prevent transactions entered from being executed or processed in the system until appropriate approvals are obtained, and the alert or block is cleared or overridden. The transactions are reviewed to ensure that deviations from agreed pricing arrangements are valid[29], and deviations are adequately disclosed to clients. For one PB, RMs were allowed to deviate from bilaterally agreed pricing arrangements without proper approvals, and disclosures to clients were only mandated when the deviation exceeded the maximum amount in the fee schedule. This is not acceptable as clients have agreed to the standing bilateral pricing arrangements, which the RMs should honour, whether or not the fee schedule has been exceeded. In some PBs, the system-enforced controls covered only a limited scope of products (e.g. equity products) - other products were omitted without good justifications. These PBs also did not have adequate mitigating or complementary post-trade checks to close the gaps in the system-enforced controls (refer to paragraph 5.5.2).

5.5.2 *Post-trade checks and surveillance* – Many PBs have implemented post-trade checks and surveillance to detect cases of over-charging. These checks are usually performed by the business control units[8], Operations or Compliance. Such checks typically involve reviewing charges that exceed fee schedules or bilaterally agreed pricing agreements against communications with clients to determine if adequate disclosures were made. MAS' inspections showed that PBs needed to increase the product coverage of such checks. Some conducted checks only on one product such as currency-linked investment trades, while others omitted various products such as preferred shares and structured products without good justifications. PBs should also review the sample size and scope of their post-trade checks, as MAS' inspections noted inadequate sampling. For example, only three trades per month were selected in one PB. Several PBs also did not conduct compliance testing on pricing controls and disclosures. PBs should conduct periodic compliance testing to assess the adequacy and quality of checks performed by the business control and operational units on pricing and disclosure.

5.5.3 *Post-trade amendment[30] to price or spread*– Most PBs have mechanisms for the business control units or Operations to check post-trade amendments of price or spread against supporting documents, including any communications with clients. This ensures that the post-trade amendments are justified, accurate and agreed with clients. This also minimises the risk of clients being unfairly charged for their transactions due to trade

[29] PBs could impose higher charges for trades involving odd-sized lots and illiquid products.

[30] This refers to alterations of the spread or price of client transactions in the PB's order management system after the client's order is executed.

amendments made by front office that clients are not aware of. A few PBs did not have controls to detect and review post-trade amendments. RMs were allowed to change pricing details[31] without being subject to proper verification or approvals. Operations staff who processed the post-trade amendments were not required to validate such changes against client instructions or other supporting documents to ensure that they were valid and agreed with clients. Management was unaware of these control gaps as there were no reports on post-trade amendments to facilitate oversight. These control lapses were also not highlighted by Compliance or Internal Audit through compliance testing or regular audits. This is an important control as post-trade amendment was a key mechanism that allowed front office to adjust spreads in order management systems so as to retain benefits arising from price improvements without appropriate disclosures to clients[32].

5.5.4 PBs with identified instances of over-charging have taken remedial actions, including contacting and refunding affected clients. These PBs conducted investigations and root-cause analyses, and established additional controls to prevent such recurrence.

Box 5 – Adherence to fee schedules and bilateral pricing arrangements

Banks communicate to clients, and agree with them, the fees, charges and any other quantifiable benefits in a timely and transparent way. This includes providing clients with fee schedules on charges for all categories of investment products and services, and informing clients of any revisions on a timely basis.

Banks disclose deviations from fee schedules and bilaterally agreed pricing arrangements to clients on a timely basis, and obtain clients' agreement or "no objection" to the deviations.

Banks disclose and agree with clients how benefits from price improvements arising from client transactions are allocated, and establish controls to adhere to such arrangements.

Banks implement adequate and effective pre-trade controls to prevent, and post-trade checks and surveillance to monitor and detect, unauthorised deviations from fee schedules and bilaterally agreed pricing arrangements.

Banks review post-trade amendments to price or spread to verify if these were authorised, justified and accurate.

[31] This included sales charges for products such as bonds, foreign exchange and equities trades.

[32] Refer to Annex A for examples of how post-trade price amendments resulted in over-charging of clients.

6 CULTURE AND CONDUCT

6.1 Good culture and conduct builds trust with clients, laying the foundation for a business' sustainable growth and financial strength. It is in the interest of PB management to build a culture that promotes ethical and prudent business practices, and the fair treatment of clients. In this regard, PB management should be mindful that the expectations and pressure placed on staff, to achieve their sales and other financial targets, do not detract them from doing right by their clients. From the conversations with the PBs' staff on their perceptions of the PBs' culture and tone-from-the-top, MAS observed some areas that PB management should pay attention to.

6.1.1 *Communicate core values and code of conduct* – All PBs communicate their core values and code of conduct to staff as part of new-joiners' induction programmes and by posting these on their websites. The management of a few PBs regularly remind staff about their core values and code of conduct, and the need to act ethically and in clients' best interests. They raised specific examples of desired or undesirable conduct on a non-attributable basis and lessons learnt from past incidences or from the industry. The RMs of these PBs have strong recollection of messages from senior management, and clarity over the boundaries of acceptable and unacceptable behaviour. On the other hand, the RMs of some PBs could not recall strong messages from management and were unable to articulate what the PB's core values meant in their day-to-day work and what they translated into in terms of behavioural expectations. Overall, there was room for PB management to, not only improve the communication of core values and the code of conduct, but also exemplify how these should be lived out in practice.

6.1.2 *Communicate clear and balanced key performance indicators (KPIs)* – All PBs subject front office staff to KPIs which consider both financial and behavioural and conduct factors. Instances were noted where staff did not have an accurate and consistent understanding of their KPIs, partly due to changes that were not clearly communicated to staff. Staff in PBs that are expanding could be under pressure to meet their targets, which may potentially give rise to inappropriate sales practices as they strive to perform and deliver results. Management should ensure that the KPIs set for staff are clear and balanced, so that business growth do not come at the expense of ethics, prioritising clients' interests and prudent risk-taking.

6.1.3 *Convey implications of misconduct and inappropriate behaviour* – Several PBs conduct sessions to share lessons from public misconduct cases in the industry. These PBs did not actively share lessons from actual cases of misconduct and inappropriate behaviour by their own RMs, citing staff confidentiality considerations. Some PBs believed that staff were aware of such internal cases through informal means, but the conversations revealed that staff had an uneven level of awareness of the facts of cases and their implications. The sharing of internal cases on a non-attributable basis could be impactful, especially if management uses these cases to reinforce what constitutes unacceptable behaviour and demonstrates that it supports the consequential disciplinary measures. Management should explore formal ways to share lessons from internal cases of misconduct and inappropriate behaviour, in addition to lessons learnt from the industry.

6.1.4 *Use "carrot" in addition to "stick"* – Most PBs implement consequence management frameworks, including disciplinary actions and penalties, to deal with staff misconduct and inappropriate behaviour. A few PBs have the practice of identifying staff with exemplary behaviour, in terms of living out its core values and code of conduct, to celebrate and recognise such behaviour. PBs can do more to celebrate and recognise exemplary behaviour. This supplements their consequence management framework through the positive reinforcement of desired behaviour.

6.1.5 *Be mindful of sub-cultures* – Several PBs have experienced significant changes and growth in their front offices due to acquisitions and new hires. Management integrating new RMs and other front office teams in the PB should be alert to the risk of sub-cultures forming under such circumstances. The formation of sub-cultures could undermine efforts to build a cohesive culture aligned with the PB's core values.

6.2 MAS encourages the Board and senior management of PBs to set a strong tone-from-the-top with respect to its core values, what they mean in terms of desired behaviour, and the importance of putting their clients' interests first.

Box 6 – Culture and conduct

Board and senior management should:

- Foster a culture of good conduct by setting a strong tone-from-the-top on the bank’s core values and code of conduct.
- Communicate KPIs against which staff are appraised in performance evaluation and remuneration frameworks clearly. These KPIs should adequately consider behavioural and conduct factors, in addition to financial KPIs.
- Ensure that the pressure on front office to achieve business targets does not come at the expense of high ethical standards, prudent risk management and prioritisation of clients’ interests.
- Exemplify organisational values and desired conduct by “walking the talk” or role-modelling.
- Set clear boundaries of desirable and unacceptable behaviour, and improve the frequency and clarity of tone-from-the-top with respect to issues relating to the sales and advisory process, including the need to be transparent with clients on pricing issues.
- Convey the consequences of unacceptable behaviour and share lessons learnt from past misconduct cases, industry developments, as well as case studies of moral dilemmas.
- Give due recognition and celebrate exemplary behaviour – use “carrot” in addition to “stick”.
- Be mindful of sub-cultures, as they could undermine cohesion and teamwork and impede achievement of organisational goals. Banks that are expanding rapidly through acquisitions or new hires should be particularly cognisant and alert to this.

7 CONCLUSION

7.1 The manner in which PBs conduct their sales and advisory activities directly influences their clients' and the public's perception of, and trust in, the private banking and wealth management sector in Singapore. To engender confidence and trust, which are critical to the long-term success of our wealth management sector, PBs should place their clients' interests at the heart of their sales and advisory activities. This means, among other things, taking due care to provide financial advice and recommendations that suit clients' circumstances and financial needs, and being transparent about fees and charges.

7.2 MAS' thematic inspections have shown that PBs have room to improve the design and effectiveness of control processes in the areas of investment suitability and pricing controls and disclosures. PBs have taken, or are taking, remedial actions to improve their governance framework and management oversight of these issues. MAS will continue to engage the industry to promote best practices and maintain high standards to ensure that the interests of their clients are safeguarded.

ANNEX A – SCENARIOS OF OVER-CHARGING

The inspections noted three main scenarios where clients were over-charged:

Scenario 1	Charges above fee schedules
Scenario 2	Charges above bilateral fee arrangements
Scenario 3	Post-trade price or spread increases

Scenario 1 and 2 refer to charging of clients above the fee schedules or bilateral pricing arrangements agreed with clients without adequate disclosure.

Scenario 3 refers to inappropriate post-trade price or spread increases that were not disclosed to clients. Examples of Scenario 3 are illustrated below[33].

Example 1: Agreement on trading spread was established pre-trade but subsequently breached

The spread that was initially agreed with the client was adjusted upwards on a post-trade basis to retain the benefit from price improvement when the trade was executed at a more favorable price, without disclosure and agreement with the client. The PB should have charged the client a spread of 1 as agreed, instead of 2. The PB could have taken the spread of 2, if this had been disclosed and agreed with the client.

BUY order

	Order Taking	Order Entry	Trade Execution
Interbank price	100 (agreed with client)	100	99
Spread	1 (agreed with client)	1	2 ⬆
All-in Price	101 (implied)	101	101
Overall price improvement in interbank price (entry vs execution)			1

Client should have paid 100, but paid 101

PBs should adhere to what was communicated to and agreed with a client during order taking. PBs should be transparent and only amend the price or spread after these are disclosed and agreed with the client.

[33] Examples stated are for illustrative purposes.

Example 2: Agreement on trading spread was established pre-trade but subsequently breached during order-entry

The spread and interbank price were adjusted upwards at the point of entry without disclosure to the client. These were further adjusted upwards when the trade was executed at a better price. The client should have been charged a spread of 2, but paid a spread of 4. The client could have been led to think that he had benefited from a better execution, although the full benefits were not passed on to him.

SELL order			
	Order Taking	**Order Entry**	**Trade Execution**
Interbank price	70 (agreed with client)	71	73
Spread	2 (agreed with client)	3	4 ↑
All-in Price	68 (agreed with client)	68	69
Overall price improvement in interbank price (entry vs execution)			2
Client should have received 71 but only received 69			

PBs should ensure that trade details are accurately recorded and not modified without good justifications. PBs should be transparent and only amend price or spread after these are disclosed and agreed with the client.

Example 3: Retaining benefits from price improvement without disclosure to clients

This illustrates a limit order, or where front office had committed to execute a trade at a specific price "or better". The PB had retained 100% of the price improvement from execution at a better price. The client did not know that the PB had executed the trade at a better price.

BUY order			
	Order Taking	**Order Entry**	**Trade Execution**
Interbank price	Not mentioned	99	98
Spread	Not mentioned	1	2 ↑
Order type	Limit order	Limit Order	-
All-in Price	100	100	100
Overall price improvement in interbank price (entry vs execution)			1
Client should have paid 99, but paid 100			

PBs should abide by the principal of transparency. They should disclose the benefit from price improvements, and agree with the client (on a standing or per trade basis) on how such benefits should be allocated. Clients should not be misled into thinking that the PB is passing all benefits to them, when it is not doing so.