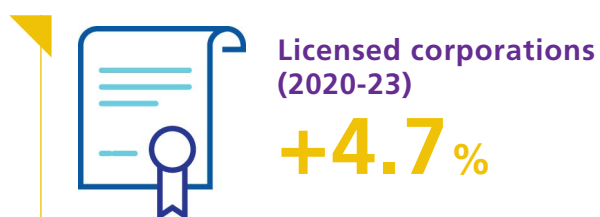


Intermediaries

We set standards and qualifying criteria for corporations and individuals licensed to operate in our markets under the Securities and Futures Ordinance. As part of our ongoing supervision, we conduct on-site inspections and off-site monitoring of licensed corporations¹ (LCs) and explain our regulatory focus and concerns to the industry. We closely monitor market and technological developments and adapt our regulatory approach to ensure our gatekeeping and supervisory functions remain effective.



Licensing corporations and individuals

As of 31 March 2023, the total number of licensed firms and individuals stood at about 48,200, which remained stable as compared with the same period of last year. With the advancement of financial technology, there were around 60 licensed firms carrying out regulated businesses in robo-advisory, virtual asset-related activities or automated trading services.

During the year, we received a total of around 7,300 new licence applications, up 3% from the previous year, comprising about 7,100 individuals and 200

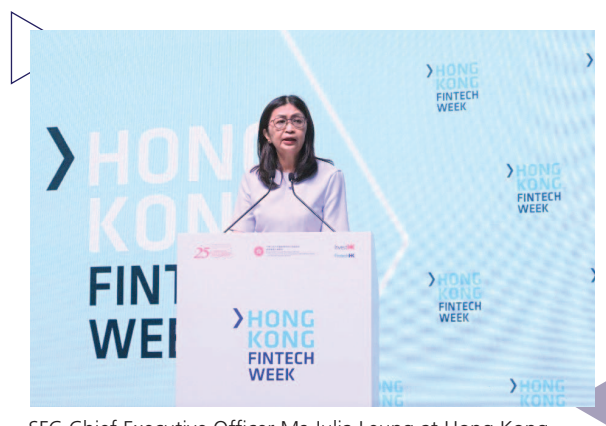
Licensees

| | Corporations [^] | | Representatives | | Responsible Officers | | Total [^] | | |
|--|---------------------------|-----------------|-----------------|-----------------|----------------------|-----------------|--------------------|-----------------|--------------|
| | As at 31.3.2023 | As at 31.3.2022 | As at 31.3.2023 | As at 31.3.2022 | As at 31.3.2023 | As at 31.3.2022 | As at 31.3.2023 | As at 31.3.2022 | Change |
| Stock exchange participants | 559 | 591 | 11,358 | 12,001 | 2,075 | 2,163 | 13,992 | 14,755 | -5.2% |
| Futures exchange participants | 91 | 99 | 737 | 827 | 143 | 178 | 971 | 1,104 | -12% |
| Stock exchange and futures exchange participants | 83 | 93 | 5,269 | 5,101 | 668 | 680 | 6,020 | 5,874 | 2.5% |
| Non-stock/non-futures exchange participants | 2,521 | 2,448 | 18,080 | 17,730 | 6,598 | 6,379 | 27,199 | 26,557 | 2.4% |
| Total | 3,254 | 3,231 | 35,444 | 35,659 | 9,484 | 9,400 | 48,182 | 48,290 | -0.2% |

[^] These figures exclude 112 registered institutions as at 31 March 2023 and 111 as at 31 March 2022.

¹ Broadly, LCs include securities brokers, futures dealers, leveraged forex traders, fund managers, investment advisers, sponsors and credit rating agencies.

² From 1 April 2023 to 31 March 2024.



SFC Chief Executive Officer Ms Julia Leung at Hong Kong FinTech Week 2022

corporations. We approved around 200 new corporate and 6,400 individual licence applications respectively. For the new licensed corporation applications approved during the year, Type 9 (asset management) regulated activity accounted for 44% and Type 4 (advising on securities) regulated activity for 35%. As of 31 March 2023, the number of firms licensed for Type 9 regulated activity (asset management) increased by 80 to almost 2,100.

Licensing fee waiver

In light of market conditions, we waived the annual licensing fees for all intermediaries and licensed individuals for the 2023-24 financial year². This measure will help the industry save approximately \$250 million.

Intermediaries

Enhancing our regulatory regime

Licensing virtual asset service providers

As of 31 March 2023, we granted two licences under the Securities and Futures Ordinance to virtual asset trading platform operators in Hong Kong.

In December 2022, the Legislative Council passed the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, enabling the new licensing regime for virtual asset service providers to take effect on 1 June 2023. Under the new regime, all centralised virtual asset trading platforms carrying on business in Hong Kong or actively marketing to Hong Kong investors must be licensed by the SFC.

We consulted the public on the proposed regulatory requirements for virtual asset trading platforms in the first quarter of 2023. In line with our regulatory stance

since 2018³, the proposed requirements include robust measures to protect investors, following the “same business, same risks, same rules” principle. Our well-defined regulatory framework provides clarity and consistency to the market which helps foster innovation, market development and investor protection.

Risk management guidelines for futures dealing activities

In November 2022, we launched a two-month public consultation on proposed risk management guidelines for licensed persons dealing in futures contracts⁴. The proposed guidelines align with regulations in major jurisdictions and take account of the views of a wide spectrum of industry practitioners who were soft consulted earlier. The consultation closed in January 2023 and we are analysing the responses received.

Financial position of the Hong Kong securities industry^a

| | As at 31.12.2022 | As at 31.12.2021 | As at 31.12.2020 |
|---|------------------------------------|------------------------------------|------------------------------------|
| Securities dealers and securities margin financiers | 1,439 | 1,433 | 1,391 |
| Active clients ^b | 4,650,024 | 4,159,100 | 3,207,677 |
| Balance sheet | (\$ million) | (\$ million) | (\$ million) |
| Total assets | 1,452,449 | 1,658,553 | 1,812,475 |
| Total liabilities | 969,051 | 1,130,341 | 1,346,418 |
| Total shareholders' funds | 483,398 | 528,212 | 466,057 |
| | 12 months to 31.12.2022 | 12 months to 31.12.2021 | 12 months to 31.12.2020 |
| Profit and loss | | | |
| Total value of transactions ^c | 126,014,719 | 160,931,088 | 129,651,195 |
| Net securities commission income | 20,210 | 31,329 | 28,374 |
| Total operating income | 187,385 | 217,469 | 198,026 |
| Total overheads and interest expense | 170,730 | 173,978 | 167,122 |
| Total operating profit | 16,655 | 43,491 | 30,904 |
| Net profit on proprietary trading | 6,211 | 21,397 | 16,649 |
| Net profit | 22,866 | 64,888 | 47,553 |

a Data were extracted from the monthly financial returns submitted under the Securities and Futures (Financial Resources) Rules by corporations licensed for dealing in securities or securities margin financing.

b Active clients are clients for whom the LC is required to prepare and deliver monthly statements of account in respect of the relevant reporting month under the Securities and Futures (Contract Notes, Statements of Account and Receipts) Rules.

c The total value of transactions includes trading in equities, bonds and other securities in Hong Kong and overseas.

Note: Also see Table 8 in Operational Data on page 182 for more details.

3 The SFC issued its *Statement on regulatory framework for virtual asset portfolios managers, fund distributors and trading platform operators* in November 2018.

4 The consultation followed our 2021 fact-finding exercise which surveyed futures brokers' business and risk management practices.

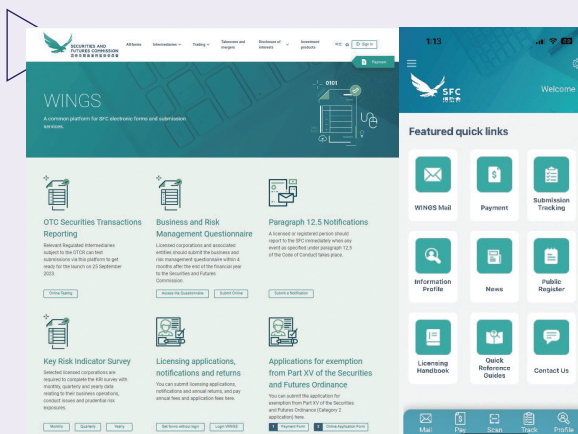


Fully digitalising the SFC licensing platform

The SFC has moved to a paperless licensing process and the online submission of corporate licence applications, notifications and regulatory filings via WINGS^a has been mandatory since 1 April 2022.

This has shortened the average processing time^b for granting in-principle approval^c to a new corporate licence application^d by 20% year-on-year, and reduced the number of long outstanding corporate applications by over 50% during the year.

Our fully digitalised licensing platform, WINGS 2.0, and its companion mobile application, WINGS Mobile, provide users with a secure, paperless system to sign and submit licensing applications and submissions electronically as well as an electronic system for the payment and settlement of application fees and a convenient communication channel to securely communicate with their case officers. These new features provide greater convenience to the industry and enhance the efficiency of the licensing process.



WINGS on the SFC's website (left) and mobile app

Industry participants quickly became familiar with the platform. As of 31 March 2023, 98% of LCs had activated their WINGS accounts and 66,000 WINGS accounts were in use. In addition, more than 208,000 applications, notifications and filings had been submitted via WINGS and over \$67 million was paid to the SFC electronically. Based on our estimate, at least 620,000 sheets of paper^e were saved since the launch of WINGS 2.0.

- a Web-based INteGrated Service.
- b For this purpose, licence applicants which have complex business models or fitness and properness issues or are unresponsive to our requisitions are included in calculating the average processing time.
- c We grant an in-principle approval to a corporate applicant which has generally satisfied us with its fitness and properness to be licensed but still has to clear certain outstanding matters such as capital injection, onboarding of responsible officers, availability of office premises and bank accounts.
- d This covers corporate licence applications submitted via WINGS as electronic submission became mandatory from 1 April 2022.
- e About 60 trees.

We will carefully consider market feedback before finalising the guidelines and provide the industry with sufficient preparation time prior to implementation.

Supervising licensed firms

We adopt a front-loaded, risk-based approach to supervising LCs, focusing on the greatest threats and the most significant or systemic risks. Our supervision of LCs focuses on their business conduct and financial soundness. We closely monitor their operations and risk management, and carry out stress tests to ensure their resilience, particularly in times of extreme market conditions. We also provide timely guidance to help intermediaries comply with regulatory requirements.



↓ 20%

Average processing time for new corporate licence applications⁵

On-site reviews

On-site reviews are a key supervisory tool for us to understand LCs' business operations, risk management and internal controls and to gauge their compliance with legal and regulatory requirements.

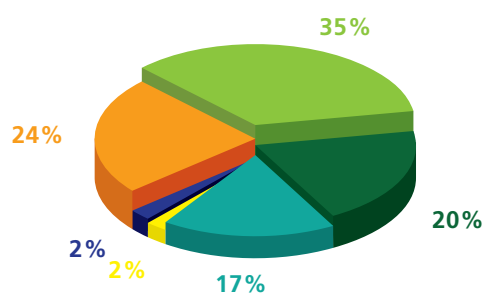
⁵ For granting an approval in principle, and change is on a year-on-year basis. The electronic submission via WINGS became mandatory from 1 April 2022.

Intermediaries



During the year, we carried out 226 risk-based on-site inspections, including those conducted remotely owing to the COVID-19 pandemic. We noted instances of breaches of our rules and regulations⁶, mainly the Code of Conduct⁷, Fund Manager Code of Conduct and Anti-Money Laundering Guidelines as well as internal control weaknesses.

Breaches noted during 2022/23 on-site inspections



| | |
|--|---------------------------------------|
| Internal control weaknesses | Failure to safekeep client money |
| Breach of Code of Conduct | Failure to safekeep client securities |
| Non-compliance with anti-money laundering guidelines | Others |

This year's thematic inspections covered LCs' selling practices, anti-money laundering and counter-financing of terrorism (AML/CFT) measures and data standards for order life cycles.

Off-site monitoring

We conduct off-site monitoring of LCs' operations by analysing the information in their regulatory filings and intelligence from other sources. We also interact regularly with LCs to assess their financial strength, internal controls and risk management practices.

Assessing prudential and conduct risks

New conduct requirements for capital market transactions

We issued a set of frequently asked questions (FAQs) to provide guidance to intermediaries on the application of the requirements⁸ for bookbuilding and placing activities in capital market transactions which took effect on 5 August 2022. The guidance covered, amongst other matters, requirements for orders placed on an omnibus basis, clarifications related to debt offerings with syndicates comprising members in Hong Kong and overseas jurisdictions, as well as transitional arrangements.

Breaches noted during on-site inspections

| | 2022/23 | 2021/22 | 2020/21 |
|--|--------------|--------------|--------------|
| Internal control weaknesses ^a | 430 | 427 | 515 |
| Breach of Code of Conduct ^b | 243 | 265 | 262 |
| Non-compliance with anti-money laundering guidelines | 214 | 301 | 208 |
| Failure to safekeep client money | 26 | 35 | 35 |
| Failure to safekeep client securities | 27 | 23 | 28 |
| Others | 290 | 365 | 302 |
| Total | 1,230 | 1,416 | 1,350 |

a Comprised deficiencies in management review and supervision, operational controls over the handling of client accounts, segregation of duties, information management and the adequacy of audit trails for internal control purposes, amongst other weaknesses.

b Commonly related to risk management, client agreements, safeguarding of client assets and information for or about clients.

Note: See Table 2 in Operational Data on page 177 for more details.

⁶ See Table 2 of Operational Data on page 177 for details.

⁷ Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

⁸ Including the Amendments to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission and the Guideline to sponsors, underwriters and placing agents involved in the listing and placing of GEM stocks.

Joint survey on the sale of non-exchange traded investment products

In September 2022, we and the Hong Kong Monetary Authority published a report on our annual joint survey on the sale of non-exchange traded investment products. The survey results help both regulators better understand market trends, identify risks and strengthen our supervisory work to protect investors.

The survey found that the number of investors who purchased investment products during 2021 increased 5% from the previous calendar year to 770,000. The total number of firms engaged in the sale of investment products also increased 5% to 390, amongst which 327 were LCs. Structured products continued to account for the largest share of the

Reviewing online brokerage, distribution and advisory services

Technological advances have transformed the way investors behave and how they access financial services, with more and more LCs serving clients through online platforms. As a principles-based regulator, we adopt a technology-neutral approach to the rules which apply in a digital environment. We have provided guidance in a number of areas—such as non-face-to-face account opening, cybersecurity and online distribution and advisory platforms—to facilitate the industry’s use of new technology in a secure and compliant manner.

our review of 50 LCs providing online services, particularly their compliance with regulatory requirements when onboarding clients and distributing or advising on investment products online. We also reminded LCs of the regulatory standards expected of them when carrying out their business activities online.

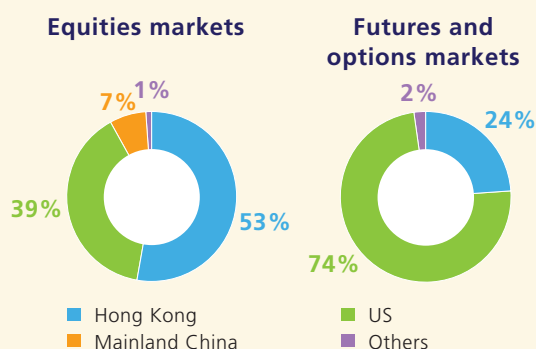
In August 2022, we issued a circular and a report to highlight the key observations and findings from

With retail investors’ increased use of online platforms, we urged LCs to review their systems, controls and procedures, having regard to the expected standards set out in our circular and report, and ensure that their online platforms are properly designed and operate in compliance with all applicable rules and regulations.

Key observations:

- New accounts were predominantly opened online using non-face-to-face approaches.
- The most commonly-offered products were exchange-traded products such as equities, exchange-traded funds and futures and options contracts.
- Increasingly, online brokers also offered CIS (including money market funds for cash management purposes) and robo-advisory services.
- Hong Kong, Mainland China and the US were the major equities markets accessed through online platforms by clients of the surveyed firms. The major futures and options markets were those in the US and Hong Kong.
- Some firms invested heavily in their online platforms to enable technical stock analyses

and facilitate investors’ own market research in a self-directed environment. This was accompanied by the use of popular social media platforms for marketing and communication purposes. Platforms which achieved economies of scale charged lower commission fees.



Protecting client assets at LCs under cessation

We require LCs to put in place effective contingency planning to ensure business continuity. If an LC ceases, or intends to cease, its business owing to either commercial reasons or significant operational disruptions which it is unable to resolve, the LC should promptly execute its exit plan to secure an orderly closure of business and return all client assets to ensure that client interests are protected.

This process can be lengthy and costly, particularly if the LC holds client assets and has to apply for paying any unclaimed client assets to the court.

Following the issuance of our March 2022 circular which provided detailed guidance on business continuity planning, we noted that the industry's awareness of the need to meet these regulatory requirements has grown. We maintain close communication with LCs in the course of our supervision to ensure that they manage contingent situations in an efficient and timely manner.

aggregate transaction amount of \$5,015 billion, followed by collective investment schemes (CIS) and debt securities. The number of firms using online platforms for the distribution of investment products increased 21% to 70.

Data standards for order life cycles

In December 2022, we issued a circular to summarise our key findings and observations from our recent thematic review of selected brokers' compliance with the data standards for order life cycles⁹. To help brokers understand and implement the standards, we amended some reporting requirements and provided examples for the data validation rules and additional FAQs. In addition, the circular strongly encouraged the industry to follow the standards and adopt appropriate technological tools to facilitate their in-house monitoring and surveillance of trading activities.

Initial margin for OTC derivatives

Under our initial margin requirements for non-centrally cleared over-the-counter (OTC) derivative transactions, an LC may, upon our approval, use a quantitative portfolio margin model (ie, a model approach) in place of a standardised margin schedule to calculate the amount of initial margin to exchange (ie, to post and collect) with its counterparties. In assessing an application for approval of a model approach, we review the applicant's implementation of the model as well as its model governance framework and risk management controls. We are currently processing several applications.

Thematic review of risk management practices

In March 2023, we published a report on our thematic review of selected LCs' practices for managing the operational and remote booking risks of trading



⁹ The data standards for order life cycles prescribe the minimum content and presentation format of trading-related data to be submitted by licensed securities brokers to the SFC upon request.



The SFC's quick licensing guides

activities as well as data risks. The report provided an overview of the industry landscape and good practices with a view to facilitating LCs' ongoing refinement of their risk management processes. We also issued a circular to highlight our expected standards for LCs to manage the operational and remote booking risks of trading activities and a separate circular on the management of data risks.

Guidance to the industry

Quick reference guides on licensing requirements

To help the industry and the public better understand the SFC's licensing regime, we published quick reference guides which cover licensing topics of particular interest to market practitioners, such as licensing requirements and carve-outs for family offices, recognition of overseas industry experience and qualifications, and exemptions from examination requirements. The guides, on family offices, private equity firms, hedge fund managers, overseas and Mainland practitioners, are available on the SFC's website and WINGS mobile app.

Anti-money laundering

To help the industry stay informed about the money laundering and terrorist financing risks in the securities sector, we issued a circular in July 2022 to draw LCs' attention to the results of the Government's newly updated *Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report*, which concluded that the securities sector's money-laundering risk remains at medium level. Our circular also highlighted key updates related to the securities sector, including new money laundering threats and vulnerabilities such as the growing number of social media investment scams, increased use of nominee and dubious investment arrangements and online trading. We reminded LCs to take the findings into account when assessing their exposure to money laundering and terrorist financing risks.

We co-hosted two closed-door meetings with the Financial Services and the Treasury Bureau and InvestHK to update virtual asset industry representatives on the key considerations behind the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022. We explained our regulatory stance on virtual assets and the direction adopted by Hong Kong, and clarified the implementation details of the new licensing regime for virtual asset service providers. We held two similar meetings with industry participants to address common queries and misconceptions about security token offerings.

In December 2022, we hosted AML/CFT webinars for 1,800 management and compliance personnel from LCs to update them on major regulatory changes which took effect on 1 June 2023 as well as new money laundering threats and vulnerabilities in the securities sector. We shared our inspection and other supervisory observations, while external speakers¹⁰ talked about terrorist financing and proliferation financing risks in Hong Kong and provided feedback on suspicious transaction reporting.

10 Including from the Commerce and Economic Development Bureau and the Hong Kong Police Force's Financial Intelligence and Investigation Bureau.

Intermediaries

Open dialogue with the industry

During the year, we delivered three virtual seminars to industry associations¹¹ to explain our recent initiatives. Key topics discussed included the digitalised licensing and financial returns submission functions on WINGS, the enhanced competency framework, business email compromise risk, anti-money laundering and the licence holders insurance scheme.

At the Hong Kong FinTech Week 2022, our Chief Executive Officer Ms Julia Leung delivered a keynote address on our latest policies on virtual assets, covering the new regime for the authorisation of exchange-traded funds with virtual asset futures as underlying assets and also security token offerings.

Alert on spoofing SMS and tips on using the SFC's Public Register

We made use of online social media platforms to remind the public to stay alert of spoofing SMS messages and investment scams and to protect their personal information and property. We also provided

tips on how to make use of the SFC's Public Register of Licensed Persons and Registered Institutions to verify the licensing status of an entity, and if in doubt, recommended approaching the staff of an LC directly using the contact information shown on the Public Register.

Warning against NFTs and virtual asset arrangements

In June 2022, we warned investors of the risks associated with non-fungible tokens (NFTs) and reminded the industry that where NFTs cross the boundary between a collectible and a financial asset, they may be subject to our regulation.

We issued a statement in December 2022 reminding investors of the risks associated with virtual asset platforms offering virtual asset "deposits", "savings", "earnings" or "staking" services to investors in Hong Kong. The statement also reminded the industry of potential legal requirements when these virtual asset arrangements are offered to investors.



Alert on spoofing SMS and tips on using the SFC's Public Register

11 Including the Hong Kong Securities Association in May 2022, and the Hong Kong Securities Professionals Association and the Hong Kong Securities & Futures Professionals Association in October 2022.