

# Strategic Priorities

Our overarching objective is to strengthen the integrity and soundness of Hong Kong's securities and futures markets. Safeguarding the interests of investors and minimising fraud and market misconduct are key to instilling investor confidence.

As part of our mandate, we also work to maintain Hong Kong's financial stability and its status as an international financial centre. To address emerging challenges and foster sustainable market development, we regularly modernise our regulatory framework and pursue close cooperation with our counterparts in Hong Kong, the Mainland and overseas.

## Adapting to change

In periods of uncertainty and volatility, we remain focussed on ensuring high-quality markets which function in a fair and orderly manner. We are pressing ahead firmly with our front-loaded regulatory approach to identify and address misconduct and market irregularities through pre-emptive and timely interventions.

The changes we implemented across our organisation over the past few years have made us more flexible, proactive and multidisciplinary. We restructured some of our operating divisions and streamlined work processes. New initiatives pooled our expertise to ensure our regulatory actions are coordinated, targeted and effective. Acting as "One SFC", the organisation is now well positioned to deploy the full range of resources and tools available to us to promote stability, resilience and financial innovation.

We monitor closely the rapid changes affecting Hong Kong and beyond as markets worldwide are highly interconnected. We adopt the latest technology to help us collect and analyse data to manage both near-term and long-term risks, and to maintain a robust market infrastructure.

Communication with the industry and the public is now more important than ever. New features introduced as part of a revamp of our corporate website this year will help us engage more efficiently with a wide range of stakeholders. The significant savings realised by our move to new office premises will help ensure our long-term sustainability.

## Current initiatives

### Listing matters

The new approach to the regulation of listing matters which we introduced in 2017 has led to improvements in a number of areas. Over the past three years, we have directly intervened at an early stage in more than 120 cases using our statutory powers under the Securities and Futures (Stock Market Listing) Rules (SMLR)<sup>1</sup> and more generally under the Securities and Futures Ordinance.

For example, we stepped up our direct interventions to tackle unfair corporate transactions in light of the growing number of instances where listed companies acquire assets at unreasonably high prices or sell assets which are substantially undervalued. Shareholders' interests could be harmed as a result. We also published guidance to flag our concerns about recurring types of misconduct and remind directors and their advisers to comply with their statutory and legal responsibilities when evaluating or approving the acquisition or disposal of a company or a business.

Tackling market and corporate misconduct will continue to be a top priority. Steps taken by our "ICE"<sup>2</sup> working group resulted in less price volatility in GEM stocks, fewer placings with a high concentration of shareholders and, overall, a more orderly market (see sidebar on page 44). The average first-day price change of GEM listings decreased from about 530% in 2016 to around 13% in 2019.

Changing corporate behaviour over the long term will require further policy adjustments. We are working closely with SEHK to update listing rules and introduce new policies such as recent rule changes to tighten the regulation of backdoor listings and shell activities.

Other initiatives focus on reforming the review structure for Listing Committee decisions and updating SEHK's disciplinary powers and sanctions. We are also exploring new policies and measures to shorten the settlement process for initial public offerings (IPOs), including an electronic platform for IPO subscriptions. To promote Hong Kong as an international financial centre and a listing venue of choice, we are working with SEHK on changes to improve access to Hong Kong markets for overseas-listed companies.

1 Under the SMLR, we may raise objections to listing applications or direct The Stock Exchange of Hong Kong Limited (SEHK) to suspend trading in a listed company's shares.

2 ICE (Intermediaries, Corporate Finance, Enforcement) is a cross-divisional working group set up to tackle corporate misconduct.

## Strategic Priorities

### Intermediaries

We adopt a risk-based approach to licensing and supervising intermediaries by focusing on the greatest threats and systemic risks.

The number of corporations and individuals we license continues to increase. To update our competency framework for licensed individuals, which has been in place since 2003, we will launch a consultation on proposed changes to the entry requirements and continuous professional training guidelines. We will also revamp our licensing portal and processing systems as we develop the next generation of our online licensing platform.

The trading and business models of our licensed corporations are increasingly complex and globalised. To assess their risk management and governance practices, a thematic review now underway focuses on their operational and data risks and their remote booking models. We have also been collaborating with overseas and local regulators to inspect our licensed corporations' risk management practices for remote booking and transfer pricing. This will help us better understand global firms' operations across jurisdictions and member companies. We are also conducting a review of the risks of using mathematical models, such as in capital calculations, derivatives pricing and risk exposure measurements, to make or inform business decisions.

To enhance our regulation of firms involved in fundraising in the equity and debt capital markets, we will consult the market soon on proposed conduct requirements based on the findings of our recent thematic inspection of their book-building activities.

In light of market volatility and liquidity issues with some overseas funds, our inspections of fund managers will focus more on liquidity risk management practices. A survey of the practices of the controllers of selected brokers will help us understand group liquidity profiles and identify potential problems for early supervisory action. On an ongoing basis, we also review brokers' risk management and compliance with the guidelines for securities margin financing activities to ensure they maintain robust risk management controls in times of market volatility.

As another priority, we are collaborating with the Hong Kong Monetary Authority (HKMA) to monitor sales practices. Our first annual joint product survey with the HKMA will cover the sale of non-exchange-



traded investment products by intermediaries during the period from 1 January to 31 December 2020. The findings will help us better understand market trends, identify risks and coordinate responses to address areas of common concern.

The potential for conflicts of interest and misconduct when firms manage trades for clients, particularly where sales staff have the discretion to control spread charges which may be in excess of those disclosed to or as agreed with the clients, will be the subject of another thematic review.

As part of the Government's continuous effort to strengthen Hong Kong's anti-money laundering and counter-financing of terrorism regime, we will commence a periodic update to the risk assessment for the securities sector to take forward the recommendations of the *Mutual Evaluation Report of Hong Kong* published by the Financial Action Task Force (FATF) in September 2019. We will also propose amendments to our anti-money laundering guidelines to align them with the latest FATF standards and provide additional risk-based guidance.

### Asset and wealth management

To develop Hong Kong as a full-service global asset and wealth management centre and a preferred fund domicile, we are committed to encouraging product innovation, broadening the market reach for Hong Kong public funds and enhancing our regulations to align with international regulatory developments.

Changes to the open-ended fund companies (OFC) regime proposed in a recent consultation, including expanding the investment scope for private OFCs and allowing securities brokers to act as their custodians, would encourage more private funds to set up in Hong Kong.

In another consultation, we proposed creating a new type of regulated activity to regulate firms acting as depositaries of SFC-authorized funds which will bring them under our regulatory oversight. We will further consult on proposed amendments to subsidiary legislation and SFC codes and guidelines in due course. We also plan to launch consultations on proposals to update the Code on Real Estate Investment Trusts and the Code on Pooled Retirement Funds.

As part of our efforts to expand market access for our funds, we are exploring mutual recognition of funds (MRF) arrangements with a number of jurisdictions<sup>3</sup>. Preparations are also underway to enhance the Mainland-Hong Kong MRF scheme to offer Mainland investors a more diversified pool of fund products managed in Hong Kong.

To strengthen Hong Kong's competitiveness as a fund domicile, we are actively involved in the Government's taskforce on establishing a new limited partnership regime for funds, providing tax concessions for local private equity funds' carried interest and other initiatives. We are also working with the HKMA and Mainland authorities to facilitate the launch of the Greater Bay Area Wealth Connect scheme which will provide mutual market access for wealth management products. This will improve the renminbi liquidity pool in Hong Kong and strengthen its role as an offshore renminbi centre.

We work closely with the industry to enhance market efficiency and liquidity to support the long-term development of our exchange-traded fund (ETF) market. Together with Hong Kong Exchanges and Clearing Limited (HKEX), we are exploring ways to enhance the ETF market-making regime. To allow more cost-effective ETF product line-ups and provide investors with more investment choice, we work to facilitate issuers' product applications under new streamlined measures for some SFC-authorized feeder ETFs.

We have also been working with the China Securities Regulatory Commission (CSRC) and other stakeholders to facilitate ETF cross-listing between the Mainland and Hong Kong to enrich our product offerings.

To gain greater insight into leverage in funds and the potential risks it may pose to the markets, we plan to upgrade fund data reporting requirements based on the latest international trends. We will issue guidance on the electronic dissemination of documentation for SFC-authorized investment products in view of the wider use of electronic media.

### Markets

Following the success of Mainland-Hong Kong Stock Connect, Hong Kong is well positioned to facilitate capital flows between the Mainland and the rest of the world. We are working with the CSRC and the stock exchanges to introduce an Exchange Bond Connect initiative for trading eligible bonds listed or traded on the Hong Kong and Mainland stock exchanges.

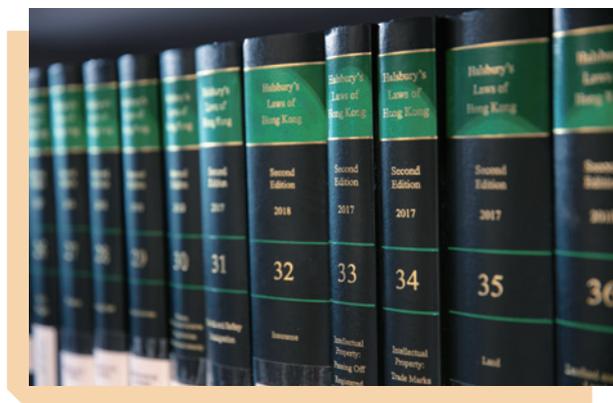
An over-the-counter (OTC) derivatives regime is being introduced in phases in Hong Kong. We will monitor the development of global reform initiatives, such as benchmark reform and the expanded scope of margin requirements for non-centrally cleared derivatives, to assess their impact on the OTC derivatives market. We are working with the Government on legislative amendments to implement refinements to the scope of regulated activities under the OTC derivatives licensing regime. We will also work with the HKMA to assess the feasibility of implementing a mandatory trading obligation.

To detect suspicious trading activities and potential market misconduct in a more timely and efficient manner, we are working with HKEX to implement an investor identification regime for the Hong Kong securities market. We aim to consult on the operational model for the regime this year.

Subsequent to the publication of a joint conclusions paper with HKEX and the Federation of Share Registrars Limited in April 2020 on introducing a paperless securities market in Hong Kong, we are working on the legislative amendments. The regime, expected to be implemented from 2022, will provide investors with efficient and meaningful options to hold and transfer securities in their own names electronically.

<sup>3</sup> Overseas MRF arrangements have been established between Hong Kong and Australia, France, Luxembourg, Malaysia, the Netherlands, Switzerland, Taiwan and the United Kingdom.

## Strategic Priorities



Following our review of HKEX's temporary suspension of the derivatives markets due to system failure in September 2019, we are monitoring the progress of its implementation of the measures we recommended. We will work with HKEX to improve its decision making process and market communications to ensure orderly market operation and prudent risk management.

### Enforcement

To protect the investing public and the reputation of Hong Kong's financial markets, we adopt a front-loaded and focussed enforcement approach to prevent and mitigate harm to investors and nip problems in the bud. We use our powers under the SFO to secure assets which are the suspected proceeds of financial crimes and act promptly to prohibit licensees which may not be fit and proper from carrying on regulated activities.

We seek to improve the quality of our markets by concentrating our enforcement resources on key risk areas and making it difficult for unlawful acts and misconduct to go undetected. One priority is to tackle highly organised corporate fraud where individuals and firms collude to defraud investors. We have commenced court proceedings against listed companies and directors at fault. We aim to deploy the full spectrum of sanctions and remedies available to us in seeking to maintain an orderly market.

Failures in handling conflicts of interest by listed company directors and licensed firms is another priority. In cases where directors breach their fiduciary duties, we may seek compensation or restorative orders against them. We will also target conflicts of interest in our disciplinary actions to raise the standards of conduct of our licensed firms.

A third focus is on market misconduct using complex and sophisticated schemes. To this end, a Market Misconduct Team has been formed by reorganising our market surveillance and investigation functions to help us detect and investigate these schemes more effectively. We will continue to target liable individuals and seek criminal and other sanctions where appropriate to send a strong deterrent message.

To more effectively tackle cross-boundary market misconduct, we strengthened our strategic cooperation with the CSRC and entered into a tripartite Memorandum of Understanding with the CSRC and the Ministry of Finance on access to audit working papers for Hong Kong-listed Mainland companies. Locally, more formal collaboration with the Independent Commission Against Corruption (ICAC) will enhance our effectiveness in combatting financial crimes and upholding market integrity.

We regularly review our data strategy to ensure that we make the best use of all available information to facilitate our investigations and deliver effective enforcement outcomes in a digital age through benchmarking our technological capabilities against our international counterparts and developing data analytic tools.

### Green and sustainable finance

We drive and coordinate efforts to bolster Hong Kong as a hub for green and sustainable finance in the region. To manage these initiatives and our engagement with counterparts more effectively, we now have a dedicated International Affairs and Sustainable Finance team<sup>4</sup>.

Promoting environmental, social and governance (ESG) criteria in asset management and corporate disclosures are priorities we set out in our September 2018 Strategic Framework for Green Finance. Additional measures to align our regulatory regime with latest international developments were outlined in our December 2019 report on our survey on integrating ESG factors and climate risks in asset management. We also worked with SEHK on updated rules which will take effect on 1 July 2020 to mandate ESG and climate change-related disclosures by companies listed in Hong Kong.

<sup>4</sup> Formerly the International Affairs team.

We stay abreast of the latest trends and standards in green and sustainable finance through our active participation in international rule-setting bodies and working groups, and collaborate with other authorities to support sustainable investment. We also work to complement Hong Kong's green and sustainable finance initiatives which contribute to the development of the Greater Bay Area and financial sector connectivity across the region.

Locally, we initiated the Green and Sustainable Finance Cross-Agency Steering Group to promote consistency and collaboration in accelerating the development of Hong Kong as a green and sustainable finance centre. Co-chaired by the SFC and the HKMA, the group's initial focus will be on cross-sectoral regulatory and market development issues. We established a Climate Change Technical Expert Group to help us develop expected standards as well as practical guidance and best practices for incorporating climate-related risks in asset managers' investment and risk management processes.

### Technology

We regularly review our regulatory regime and our internal operations to keep up with the latest technological developments and innovative business practices to ensure they are adopted effectively and securely. A major focus is on regulating the conduct of intermediaries who leverage technologies to deliver financial services. The new licensing framework for virtual asset trading platforms we announced in November 2019 brings a largely unregulated area with growing importance under our supervision.

We are developing an internal data analytic platform to automate the analysis of trading data when inspecting large securities brokers. In addition, we will revamp the returns required under the financial resources rules to collect additional financial and risk information from licensed corporations.

Fully developing our online portal, WINGS<sup>5</sup>, has helped overcome the digitalisation challenge by passing data provided by market participants straight to backend processing and analysis. We are adopting other new technologies to organise large volumes of information to make our investigation and litigation work more efficient. We plan to apply more

artificial intelligence-related technology to expand our automatic risk detection and market monitoring capability.

To strengthen our monitoring framework and mechanisms to identify changing market trends and systemic risks, we stepped up our efforts to ensure the integrity of the data we receive from the reporting regimes for OTC equity derivatives, large open positions in exchange-traded derivatives and short positions in stocks. This data provides us with the timely information we need to make a comprehensive assessment of the market situation.

### Regulatory cooperation

In supporting Hong Kong's status as an international financial centre, we foster close relationships with our local and overseas counterparts and actively participate in international regulatory bodies. Locally, we build strong connections with other regulators and enforcement agencies to advance our joint initiatives and share information. Formal cooperation arrangements we made this year with the ICAC and the Competition Commission will facilitate our exchange of information and expertise.

Our Chief Executive Officer Mr Ashley Alder serves as Chair of the Board of the International Organization of Securities Commissions (IOSCO) and ex-officio member of the Financial Stability Board (FSB) Plenary and Steering Committee. Our senior executives play an active role in IOSCO's and FSB's committees and working groups. IOSCO and FSB have cooperated very closely to respond to the COVID-19 crisis, and IOSCO has reprioritised its work programme for 2020 to focus primarily on the multiple challenges facing market participants and regulators arising from the crisis.

With greater market connectivity between Hong Kong and the Mainland, our cooperation with Mainland regulators is critically important to safeguard market integrity and investors' interests. We maintain close and effective high-level communication as well as everyday interaction with our Mainland counterparts to enhance cross-boundary regulatory cooperation and to ensure the smooth implementation of market development initiatives including the mutual market access schemes.

5 Web-based INteGrated Service.