

# Operational Review

We strive to strengthen the integrity and soundness of the financial markets through our principal areas of work: corporates, intermediaries, products, markets and enforcement.



# Highlights

## Key figures for 2019-20

**8,767**  
requests for trading and account records 

**197**  
cases initiated for investigation

**158**  
individuals and corporations subject to ongoing civil proceedings

**\$479 million**  
in fines on licensees

**6,962**  
new licence applications 

As of 31 March 2020  
**47,167**  
licensees and registrants  
including  
**3,109**  
licensed corporations

**317**  
on-site inspections of intermediaries

**73**  
industry circulars

**136**  
Fintech-related enquiries 

**103**  
senior executives' speaking engagements

**4,491**  
complaints against intermediaries and market activities

**303**  
listing applications received 

**359**  
takeovers-related transactions and applications

As of 31 March 2020  
**2,728**  
authorised collective investment schemes 

including  
**762** Hong Kong-domiciled funds

## Highlights

The following tables highlight our work during 2019-20. More details are provided in subsequent chapters.

Regulatory enhancements	
<b>Online account opening</b>	Amendments to the Code of Conduct <sup>1</sup> and a new approach to onboarding overseas individual clients allow firms to adapt their practices as business activities are increasingly conducted online
<b>Securities margin financing</b>	New guidelines took effect to enhance brokers' risk management of securities margin financing activities
<b>Listed companies</b>	In response to the SFC's recommendation, The Stock Exchange of Hong Kong Limited (SEHK) introduced a trading suspension requirement for listed companies with a disclaimer or adverse audit opinion on their financial statements Following the SFC's approval, SEHK amended rules for listed companies' environmental, social and governance (ESG) disclosure and introduced new rules to tackle problems associated with backdoor listings and shell activities
<b>Virtual assets</b>	Announced a regulatory framework for licensing virtual asset trading platforms under the SFC's existing powers
<b>Investor compensation</b>	Enhancements to the investor compensation regime took effect, raising the compensation limit to \$500,000 per investor per default and extending coverage to include northbound trading under Mainland-Hong Kong Stock Connect
<b>Investor identification</b>	An investor identification regime was implemented for southbound trading under Mainland-Hong Kong Stock Connect
<b>Open-ended fund companies</b>	Consulted the public on proposed enhancements to the open-ended fund companies (OFC) regime to encourage private funds to set up in Hong Kong
<b>Trustees and custodians of public funds</b>	Consulted the public on proposals to regulate depositaries <sup>2</sup> of SFC-authorized collective investment schemes (CIS)
<b>OTC derivatives</b>	Concluded a consultation on margin requirements for non-centrally cleared over-the-counter (OTC) derivative transactions Together with the Hong Kong Monetary Authority (HKMA), consulted the public on implementing unique trade identifiers and mandating their use in transactions to be submitted to the Hong Kong Trade Repository

<sup>1</sup> The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

<sup>2</sup> Depositaries are trustees for SFC-authorized CIS in unit trust form, and custodians for CIS in other forms.

Supervision	
<b>Listing applications</b>	Received 303 listing applications including two companies with weighted voting rights structures and 10 pre-profit biotech companies, and directly sought information or expressed our concerns about 35 applications
<b>Takeovers matters</b>	Supervised 359 takeovers-related transactions and applications The Takeovers Panel met twice during the year to consider novel, important or difficult points at issue
<b>Corporate conduct</b>	Published statements on misconduct in corporate acquisitions and disposals and to remind listed companies that announcements and documents must not include false or incomplete information about their counterparties Issued joint statements with SEHK on listed companies' reporting deadlines and general meetings for shareholders in light of the COVID-19 outbreak As part of our review of corporate disclosure, issued section 179 directions to gather additional information in 76 cases and wrote to detail our concerns in 20 transactions
<b>Licensing</b>	Revamped our licensing processes and made the use of new licensing forms mandatory to enhance efficiency and transparency Provided guidance for private equity firms and family offices on our licensing regime
<b>Inspections</b>	Conducted 317 on-site inspections of intermediaries and noted 1,489 incidents of breaches of our rules Completed an on-site inspection of Hong Kong Exchanges and Clearing Limited's (HKEX) futures trading and clearing operations covering July 2016 to June 2018 and recommended improvements
<b>Asset managers</b>	Issued guidance on the conduct expected of asset managers when considering dubious private fund and discretionary account arrangements or transactions requested by investors Published a report on our survey on integrating ESG factors and climate risks in asset management Released the <i>Asset and Wealth Management Activities Survey</i> for 2018 to provide a comprehensive overview of the industry in Hong Kong
<b>Third-party deposits and payments</b>	Issued a circular setting out our expected standards and providing examples of effective measures for firms to prevent the misappropriation of client assets, money laundering and other financial crimes associated with third-party deposits and payments
<b>Complex financing arrangements</b>	Issued a joint circular with the HKMA on complex, opaque financial transactions within financial groups which may conceal embedded financial risks
<b>Prime brokerage business</b>	Published a circular and a report setting our expected standards of conduct and internal controls on prime brokers in Hong Kong, and sharing examples of good industry practices
<b>Industry guidance</b>	Organised the SFC Compliance Forum 2019 to exchange views with the industry on recent regulatory guidance, expected standards of conduct and topical issues Issued 73 circulars to the industry on a wide range of topics including fund liquidity risk, client facilitation, protection of client assets, private equity firms and family offices Created a dedicated webpage to provide the latest regulatory information during the COVID-19 outbreak

## Highlights

### Market development

<b>Paperless securities market</b>	Concluded a joint consultation with HKEX and the Federation of Share Registrars Limited on a proposed operational model for an uncertificated securities market
<b>Mutual recognition of funds</b>	Signed a mutual recognition of funds (MRF) agreement with the Netherlands Authority for the Financial Markets, allowing eligible Dutch and Hong Kong funds to be distributed in the other market through a streamlined process <sup>3</sup>
<b>Funds</b>	Authorised 126 CIS for sale to the public in Hong Kong
<b>OFC</b>	The first authorised exchange-traded fund (ETF) structured as a public OFC was listed and two private OFCs were registered
<b>ETF</b>	Worked with SEHK to introduce a new buy-in exemption to cover short positions associated with ETF market-making activities Authorised the world's first iron ore futures ETF
<b>Derivative products</b>	Approved 12 derivative contracts proposed by HKEX

### Enforcement

<b>Surveillance</b>	Made 8,767 requests for trading and account records from intermediaries as a result of surveillance of untoward price and turnover movements
<b>Investigations and prosecutions</b>	Commenced 197 investigations and laid 10 criminal charges against six individuals and one corporation and secured convictions against three persons
<b>Notable disciplinary actions</b>	Reprimanded and fined one firm \$400 million for overcharging clients over a 10-year period through post-trade spread increases, excess fees and internal control failures Reprimanded and fined one firm \$27 million for failures as an initial public offering sponsor Disciplined three individuals and one firm for failures in complying with anti-money laundering and counter-terrorist financing requirements Banned four individuals from re-entering the industry for life for conviction of bribery or theft

### Regulatory cooperation

<b>Hong Kong</b>	Entered into a memorandum of understanding (MoU) with the Independent Commission Against Corruption to formalise our cooperation in combating financial crime
<b>Mainland</b>	Held two high-level meetings with the China Securities Regulatory Commission (CSRC) to discuss supervisory and regulatory cooperation Entered into an MoU with the Ministry of Finance and the CSRC on access to audit working papers for Hong Kong-listed Mainland companies

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

# Corporates

We oversee listing and takeovers matters in Hong Kong, including takeovers and merger activities, vetting of listing applications, disclosure requirements, corporate conduct and the listing-related functions of The Stock Exchange of Hong Kong Limited (SEHK). We review listing and takeovers policies to facilitate the development of a fair and orderly securities market in Hong Kong.

## Listing regulation

### Corporate and market misconduct

We work together with SEHK to monitor the market and intervene using our statutory powers under the Securities and Futures (Stock Market Listing) Rules (SMLR) and the Securities and Futures Ordinance (SFO) where appropriate to tackle corporate and market misconduct.

Following a public consultation and our approval, SEHK introduced amendments to the Listing Rules in July 2019 to tackle problems associated with backdoor listings and shell activities. The changes took effect on 1 October 2019. Concurrently, we issued a statement explaining our general approach to these activities. Before deciding whether to exercise our statutory powers, we consider the facts and circumstances of each case, including any red flags indicating a possible scheme designed to mislead regulators or the investing public or to circumvent applicable rules.

In response to a recommendation in our review of SEHK's performance in listing matters, SEHK introduced a trading suspension requirement for listed companies with a disclaimer or adverse audit opinion on their financial statements. The new rule applies to preliminary annual results announcements for financial years commencing on or after 1 September 2019.

In July 2019, we issued a statement on recurring misconduct in corporate acquisitions and disposals which has prompted intervention by the SFC. Directors and their advisers were reminded to comply with their statutory and other legal duties when evaluating or approving the acquisition or disposal of a company or business.



Presentation at a seminar hosted by The Hong Kong Independent Non-Executive Director Association

To address the use of special purpose vehicles and other means (including private funds) to conceal ownership and as part of wider schemes to engage in illicit activities or market misconduct, we issued a statement in November 2019 reminding listed companies that their announcements and other documents must not include false, incomplete or misleading information about their counterparties in a transaction. Our statement was accompanied by guidance to asset managers on the conduct expected of them when considering dubious private fund and discretionary account arrangements or transactions.

### Corporate WVR

Following discussions with us, SEHK consulted the public in early 2020 on a proposal to allow corporations to benefit from weighted voting rights (WVR), subject to additional conditions and investor safeguards to address risks which are particular to corporate WVR, such as the potential for WVR structures to subsist indefinitely.

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## New listing applications

	2019/20	2018/19	2017/18
Listing applications received <sup>a</sup>	303	394	309
Listing applications lapsed/withdrawn/rejected during the year	172	166	88
Listing applications returned <sup>b</sup>	3	0	3
New listings <sup>c</sup>	182	193	203

a Including applications for transfer from GEM to the Main Board (2019/20: 29; 2018/19: 16; 2017/18: 22).

b Listing applications were returned by SEHK because the application proofs or related documents were not substantially complete. The listing applicants can only submit a new listing application with a new application proof not less than eight weeks after the return.

c Including successful transfers from GEM to the Main Board (2019/20: 16; 2018/19: 11; 2017/18: 17).

## Reporting deadlines

On 4 February 2020, we issued a joint statement with SEHK in response to market concerns about possible delays in publishing preliminary or audited financial results due to the COVID-19 outbreak. The statement clarified that a listed company which cannot publish preliminary results with its auditors' agreement before the reporting deadline would be allowed instead to publish them without auditor's agreement, or to publish management accounts or material financial information. In these cases, SEHK would normally allow trading in the companies' shares to continue.

We jointly issued further guidance on 16 March 2020 stating that these listed companies may defer the publication of their annual reports until not later than 15 May 2020. Listed companies which require more time can apply for further relief on a case-by-case basis.

## General meetings

Following the Government's regulation restricting the size of group gatherings, we issued a statement jointly with SEHK on 1 April 2020 to provide guidance to listed companies in determining the timing of general meetings for shareholders as well as the manner in which they are held.

## Debt market

Together with SEHK, we regularly review the debt capital market regime. In December 2019, SEHK launched a consultation seeking feedback on its proposals to review and enhance the listing regime for debt issues to professional investors.

**15**

listed pre-profit biotech companies  
as of 31 March 2020

## IPO

We vet listing applications and raise enquiries to determine whether an application gives rise to any concerns under the SMLR. We may object to a listing of securities based on one or more of the grounds set out in section 6(2)<sup>1</sup> of the SMLR.

During the year, we received 303 listing applications via SEHK, down 23.1% from 394 last year, including applications from two WVR companies and 10 pre-profit biotech companies. We shared our comments or concerns with SEHK where appropriate.

<sup>1</sup> Under section 6(2) of the SMLR, the SFC may object to a listing if it appears to the SFC that: (a) the listing application does not comply with SEHK's requirements or an applicable provision of law, or does not contain sufficient information to enable an investor to make an informed decision; (b) the application is false or misleading; (c) the applicant has failed to furnish information as may be reasonably required by the SFC under section 6(1) of the SMLR; or (d) it would not be in the interest of the investing public or in the public interest for the securities to be listed.



In line with our front-loaded regulatory approach, we directly sought information or expressed our concerns in 35 listing applications where we became aware of potentially serious disclosure or public interest issues. In two of these applications, the applicants satisfactorily addressed our concerns and were subsequently listed. One other applicant addressed our concerns but decided not to proceed with the listing. As at 31 March 2020, 20 of these applications had not proceeded to listing, leaving our concerns unaddressed, while 12 were still ongoing but the applicants had yet to satisfactorily address our concerns.

## Takeovers activities

	2019/20	2018/19	2017/18
General and partial offers under Code on Takeovers and Mergers	41	55	59
Privatisations	15	6	11
Whitewash waiver applications	13	21	41
Other applications under Code on Takeovers and Mergers <sup>^</sup>	281	275	289
Off-market and general offer share buy-backs	7	9	1
Other applications under Code on Share Buy-backs <sup>^</sup>	2	7	0
<b>Total</b>	<b>359</b>	<b>373</b>	<b>401</b>

<sup>^</sup> Including stand-alone applications and those made during the course of a Code-related transaction.

Note: Also see Table 3 in Breakdown of SFC activity data on page 161 for more details.

2 Section 179 of the SFO gives the SFC the power to compel the production of records and documents from persons related to a listed company.

## Corporate conduct

We conduct daily reviews of corporate announcements under statutory corporate conduct and inside information disclosure provisions to identify potential misconduct and irregularities. We issued section 179<sup>2</sup> directions to gather additional information in 76 cases and wrote to detail our concerns in 20 transactions this year. These concerns included, for example, overvalued acquisitions and late disclosure of inside information.

In February 2020, we published a special edition of the *SFC Regulatory Bulletin* to provide an update on our front-loaded approach to address market quality and corporate conduct issues. Case studies illustrate our key areas of concern and recent regulatory interventions in IPO applications and corporate transactions.

## Takeovers

In Hong Kong, takeovers, mergers, privatisations and share buy-backs affecting public companies are regulated by the Codes on Takeovers and Mergers and Share Buy-backs. Although the number of takeovers cases decreased this year, they involved more complex deal structures and difficult issues. The Takeovers and Mergers Panel met twice during the year to discuss novel, important or difficult points at issue.

### Update on front-loaded regulation

We have made significant progress in tackling listed company-related misconduct with a front-loaded regulatory approach which uses earlier, more targeted intervention to deal with market irregularities and protect the investing public. This approach was developed and implemented by a cross-divisional working group, designated ICE<sup>a</sup>, established in 2016.

As part of a coordinated, multidisciplinary strategy, we made strides in addressing persistent misconduct. This includes improper market activities involving shell companies, highly dilutive rights issues and GEM stocks or “bubble stocks” which show extreme price volatility. As a result of our efforts, the volatility of newly-listed GEM stocks dropped significantly. The average first-day price increase of these stocks was about 13% in 2019, down from over 500% in 2016.

Over the past three years, we directly intervened in over 120 cases involving IPOs or listed companies through the actual or potential use of our SMLR powers, significantly more than the four direct interventions in the prior three-year period. Since 2017, we have taken disciplinary actions against nine IPO sponsors for deficiencies in their due diligence practices and internal systems and controls.

In some cases, shareholders’ interests were undermined when listed companies acquired assets at unreasonably high prices or sold assets which

were substantially undervalued. We published statements and guidance to remind directors and financial advisors of their duties when valuing target assets and evaluating or approving acquisitions and disposals.

Corporate misconduct often involves concealed share ownership or control. We issued a statement in November 2019 to reiterate our concerns with the use of nominees and warehousing arrangements together with a circular to provide guidance to asset managers handling private fund and discretionary account arrangements or transactions (see page 41). We also investigated cases where nominee arrangements were used to perpetrate vote rigging and market manipulation.

We conducted search operations and targeted inspections against “networks of companies” engaged in illegal activities to profit at the expense of investors. Our investigations continue into a number of these networks, which may include listed companies, licensed corporations, money lenders and other parties.

To explain our approach to the industry and the public, we published four issues of the *SFC Regulatory Bulletin* in the past three years. The newsletter features case studies illustrating our areas of concern and recent regulatory interventions.

### Direct intervention cases

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
IPO cases	1	0	2	15	19	35
Post-IPO cases	0	0	1	17	27	12
<b>Total</b>	1	0	3	32	46	47

<sup>a</sup> ICE pools resources from the SFC’s Intermediaries, Corporate Finance and Enforcement divisions.

In a decision published in July 2019, the panel ruled that a waiver of the general offer obligation under the Takeovers Code should not be granted to China Baowu Steel Group Corporation Limited if it proceeds with the proposed acquisition of a 51% interest in Magang (Group) Holding Company Limited, the controlling shareholder of Maanshan Iron & Steel Company Limited, at nil consideration<sup>3</sup>.

In October 2019, the panel ruled that Broadford Global Limited was not allowed to deduct the final dividend approved by shareholders of Dalian Port (PDA) Company Limited from its offer price in a possible mandatory general offer. The panel considered that readers of the announcement would have expected Dalian Port's shareholders to receive the full offer price.

Following our investigations and enquiries, we sanctioned a number of parties during the year.

In April 2019, we publicly criticised Kwok Tse Wah, a party acting in concert with the offeror, for breaching the dealing restrictions and dealing disclosure obligations under the Takeovers Code when he sold shares in Hopewell Holdings Limited during an offer period.

CM Asset Management (Hongkong) Company Limited was publicly criticised in July 2019 for failing to disclose dealings in the shares of Mengke Holdings Limited<sup>4</sup> during an offer period.



In December 2019, we publicly censured CLSA Limited, CITIC Securities Brokerage (HK) Limited, Beijing Enterprises Holdings Limited and their representatives for share buy-backs conducted in 2016 in breach of the Code on Share Buy-backs. CLSA and CITIC Securities executed on-market trades in the shares of Beijing Enterprises. As these trades were pre-arranged and pre-agreed, they were in substance off-market share buy-backs which required the approval of the Takeovers Executive<sup>5</sup> and Beijing Enterprises' independent shareholders.

<sup>3</sup> Upon completion of the proposed transaction, China Baowu would trigger a mandatory general offer for Maanshan Iron & Steel Company Limited under the "chain principle" unless a waiver is obtained.

<sup>4</sup> Now known as Champion Alliance International Holdings Limited.

<sup>5</sup> The Executive Director of the SFC's Corporate Finance Division or his delegate.

## Intermediaries

We set standards and qualifying criteria for corporations and individuals licensed to operate as intermediaries in our markets under the Securities and Futures Ordinance (SFO). As part of our ongoing supervision, we conduct on-site inspections and off-site monitoring of licensed corporations (LCs)<sup>1</sup>.

**+25%**

New licensed corporations (2017-2020)

During the year, intermediaries reconfigured their staffing arrangements and overcame many operational challenges to maintain “business as usual” in response to significant disruptions arising from social events and the COVID-19 outbreak. We stepped up our supervisory work and regular stress tests to monitor LCs’ financial and operational resilience in times of market turbulence and volatility. We also conducted special inspections to ensure compliance with our internal control and risk management requirements, and engaged with the industry to provide regulatory flexibility without lowering standards or compromising investor protection.



Ms Julia Leung (left), Deputy Chief Executive Officer and Executive Director, Intermediaries, at the SFC Compliance Forum 2019

## Licensing

As of 31 March 2020, the number of licensees and registrants totalled 47,167, up 1% from last year, including the number of LCs which increased 5% to 3,109 as 254 new corporate licence applications were approved. We received a total of 6,962 new licence applications<sup>2</sup>, down 22% from the previous year.

## Licensees

	Corporations <sup>^</sup>		Representatives		Responsible Officers		Total <sup>^</sup>		
	As at 31.3.2020	As at 31.3.2019	As at 31.3.2020	As at 31.3.2019	As at 31.3.2020	As at 31.3.2019	As at 31.3.2020	As at 31.3.2019	Change
Stock exchange participants	604	581	12,208	12,397	2,196	2,155	15,008	15,133	-0.8%
Futures exchange participants	113	114	870	849	200	199	1,183	1,162	1.8%
Stock exchange and futures exchange participants	84	81	4,862	5,002	612	576	5,558	5,659	-1.8%
Non-stock/non-futures exchange participants	2,308	2,184	16,934	16,655	6,064	5,769	25,306	24,608	2.8%
<b>Total</b>	<b>3,109</b>	<b>2,960</b>	<b>34,874</b>	<b>34,903</b>	<b>9,072</b>	<b>8,699</b>	<b>47,055</b>	<b>46,562</b>	<b>1.1%</b>

<sup>^</sup> These figures exclude 112 registered institutions as at 31 March 2020 and 116 as at 31 March 2019.

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

2 The figure does not include applications for provisional licences.

## COVID-19 response

Beginning in January 2020, we responded actively to the impact of the COVID-19 outbreak to ensure that Hong Kong's international financial markets function efficiently, effectively and resiliently amidst extreme volatility and operational challenges<sup>a</sup>. We maintained close communication with firms and industry associations and issued guidance which set out our regulatory expectations during a critical time<sup>b</sup>.

At the same time, we took a flexible approach to ease pressure on the industry. We deferred regulatory timetables by six months<sup>c</sup> and reminded intermediaries of alternative order receiving and recording options to comply with the regulatory requirements when working out of office. Firms required to submit their audited accounts to us were advised that they may apply for an extension.

a See press release dated 21 April 2020.

b See press release dated 5 February 2020.

c See circular dated 31 March 2020.

We published FAQs on licensing matters and application procedures for fund authorisations, and issued joint guidance with The Stock Exchange of Hong Kong Limited to address market concerns about listed companies' preliminary earnings results, publication of annual reports and shareholder meetings.

To ensure that firms and financial market infrastructures manage their risks and operate in a normal manner, we stepped up our supervisory efforts to address potential vulnerabilities, including investment fund liquidity and redemption profiles.

In March, we launched a dedicated page on our corporate website to provide centralised access to up-to-date regulatory information related to the COVID-19 situation.

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## Enhanced licensing processes

In April 2019, our enhanced risk-based licensing process came into effect. New licensing forms collect more information to assess an applicant's fitness and properness, reducing the need for us to request additional information. Processing times have decreased and the number of applications outstanding for over 90 days dropped 38% during the year.

We engaged with the industry throughout the design and implementation of the revamped licensing process. In May 2019, we published frequently asked questions (FAQs) to clarify the new disclosure requirement for internal investigations of licensed individuals<sup>3</sup>, which has helped us identify potential misconduct. We also consulted the industry on our next generation of online licensing portal services, which we aim to launch in late 2020.

## PE firms and family offices

We issued circulars to provide licensing guidance to private equity (PE) firms and family offices in January 2020 in response to enquiries from industry

participants and their professional advisers. The circular on PE firms explained the licensing requirements for general partners and investment committee members when conducting co-investment and fund marketing activities. The circular on family offices discussed how our licensing regime applies to them when carrying out asset management or other services in Hong Kong and explained the potential implications for both single and multi-family offices. We also set up designated email addresses for interested parties to enquire about our licensing requirements or discuss their business plans with us.

## Annual licensing fees

The collection of annual licensing fees resumed on 1 April 2019 with a 50% fee concession. In view of a challenging market environment, we waived the annual licensing fees for all intermediaries and licensed individuals for the 2020-21 financial year.

<sup>3</sup> The requirement applies to internal investigations commenced within six months preceding the individual's cessation of accreditation.

## Intermediaries

### Prudential risks

#### Securities margin financing

In times of extreme market volatility such as that triggered by the widespread concern about COVID-19, it is particularly important for brokers engaging in securities margin financing activities to maintain robust risk management controls. Our guidelines for securities margin financing activities which took effect on 4 October 2019 provide guidance on concentration risks, margin calls, stress tests and other key risk controls.

Improved stress test results suggest that brokers' resilience to market volatility was enhanced following the implementation of the new guidelines. Also, securities collateral concentration risk was reduced with brokers reporting fewer concentrated and illiquid stocks. To facilitate the implementation of the new guidelines, we published FAQs to clarify the application and interpretation of some requirements in September 2019. We also held training sessions for the industry and posted an e-training video on our website.

#### Complex financing arrangements

We issued a joint circular with the Hong Kong Monetary Authority in April 2019 on complex and opaque financing arrangements within a Mainland-based financial group's LC, bank and another affiliate in Hong Kong. Through arrangements such as an investment in a fund, the group's credit risk could be disguised as an investment risk and the financial risks associated with the underlying investments could be concealed.

We also identified financial risks in the controllers of a few brokers. If these risks materialise, they may spill over to the licensed brokers and cause financial and reputational damage. A survey of the liquidity management of the controllers of selected brokers which we commenced in January 2020 will help us understand the liquidity profiles of these groups and identify potential financial problems so that we can take early supervisory action to protect investor interests. Controllers of LCs were reminded to prudently manage overall group financial risks and contain contagion risks which may affect the LCs' financial integrity.

### Managing liquidity risk in funds

Our August 2019 circular highlighted deficiencies noted in fund managers' liquidity risk management practices. We reminded them to perform more frequent stress tests to assess the liquidity profiles of funds' assets and liabilities as well as the adequacy of their action plans and liquidity risk management tools.

In light of the volatility in equities and bond markets arising from the COVID-19 outbreak, we issued a circular on 27 March 2020 to remind intermediaries of their obligation to ensure suitability when they make a solicitation or recommendation. This includes performing due diligence having regard to an investment product's liquidity and credit quality. Intermediaries were also reminded to disseminate notices and other communications about investment products in a timely manner where they hold them directly or indirectly on behalf of their clients.

### OTC derivatives

New risk mitigation requirements for non-centrally cleared over-the-counter (OTC) derivative transactions covering trade confirmation, valuation and portfolio reconciliation took effect on 1 September 2019.

We concluded a consultation in December on proposals to impose margin requirements for non-centrally cleared OTC derivative transactions. Variation margin requirements will take effect on 1 September 2020. In view of the COVID-19 situation, we aligned the implementation of the initial margin requirements with the revised international timetable and they will be phased in starting 1 September 2021.

### Conduct risks

#### Client facilitation

A May 2019 circular shared our inspection findings related to client facilitation and reiterated that licensed brokers and their traders should obtain explicit client consent prior to each client facilitation trade. It also clarified that client consent should never be uni-directional, blanket, implied by the making of disclosure or obtained after the trade.

## Credit rating agencies

We highlighted our concerns about credit rating model risk management in a circular to credit rating agencies in May 2019. The circular elaborated on our expected standards which cover the governance and use of credit rating models, model validation and data quality.

## Prime brokers

Following our thematic review of prime services and related equity derivatives business in Hong Kong, we issued a circular and a report in June 2019 setting out our expected standards of conduct and internal controls for prime brokers, and sharing examples of good industry practices. In particular, prime brokers are expected to comply with the applicable rules and regulations in Hong Kong if they service clients or carry out prime services in Hong Kong, regardless of where the risk positions are booked.

## Anti-money laundering

In April 2019, we updated the anti-money laundering and counter-terrorist financing (AML/CFT) Self-Assessment Checklist on our website to provide a structured framework for LCs and associated entities to assess their compliance.

In September 2019, the Financial Action Task Force published the *Mutual Evaluation Report of Hong Kong* which recognised that we have a reasonable risk-based supervisory framework for AML/CFT and commended our sanctions to enforce requirements for the securities sector. It assessed Hong Kong's AML/CFT regime as compliant and effective overall and recommended some priority actions. In the same month, we issued a circular informing LCs about the assessment results and areas for strengthening Hong Kong's AML/CFT regime.

## Third-party deposits and payments

In May 2019, we issued a circular on our expected standards in areas where LCs failed to implement adequate policies and controls to mitigate the risks of client assets misappropriation, money laundering and other financial crime associated with third-party deposits and payments. We also provided examples of effective measures to promote compliance.



Presentation at a Hong Kong Venture Capital and Private Equity Association seminar in November 2019

## Dubious fund arrangements

In a November 2019 circular, we provided guidance to asset managers considering private fund and discretionary account arrangements or transactions proposed or directed by investors. We emphasised that we would not hesitate to take regulatory action against asset managers and senior management if they fail to detect dubious arrangements or transactions or if they facilitate illegal or improper conduct due to inadequacies in their procedures and controls.

## Regulatory enhancements

### Online client onboarding

Amendments to the Code of Conduct<sup>4</sup> took effect on 5 July 2019 to cater for intermediaries' need to adapt their practices as business activities are increasingly conducted online. To facilitate compliance, we specified acceptable account opening approaches on the SFC website and explained them in circulars and FAQs. A new approach to onboarding overseas individual clients online took effect on the same date.

### Safeguarding client assets

Our July 2019 circular reminded intermediaries of their obligations to adequately safeguard client assets. They are required to have in place acknowledgement letters which stipulate that authorised institutions would not have any right of set-off or lien against intermediaries' client assets. The deadline for implementing the new requirement was extended by six months to February 2021.

<sup>4</sup> The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

## Intermediaries

### External electronic data storage

In October 2019, we issued a circular on the use of external electronic data storage to set out the approval and other requirements applicable to LCs which keep regulatory records exclusively with external electronic data storage providers. Where a data centre was approved under section 130 of the SFO before 31 October 2019, the deadline for the LC to provide us with the confirmation and documentation was extended by six months to 31 December 2020.

**922**

on-site inspections in the past three years

### Supervisory approach

We adopt a front-loaded, risk-based approach focusing on the greatest threats and the most significant or systemic risks. Our supervision of LCs focuses on financial risks and how they conduct business.

In light of the business disruption and increased market volatility worldwide across equities, commodities and fixed income amid the COVID-19 outbreak, we closely monitored the operation and risk management of LCs, conducted stress tests and followed up with

high-risk LCs. We also provided timely guidance to intermediaries to help them comply with regulatory requirements.

### On-site reviews

On-site reviews are a key supervisory tool for us to understand an LC's business operations, risk management and internal controls and gauge its compliance with legal and regulatory requirements. During the year, we conducted 317 risk-based on-site inspections and noted more than 1,400 breaches of the SFC's rules.

This year's thematic inspections covered AML/CFT, cybersecurity, intermediary misconduct in listed markets, complex and opaque financing arrangements, remote booking and operational and data risk management as well as book-building activities.

### Off-site monitoring

We conduct off-site monitoring by analysing the information in regulatory filings, such as the financial returns and business and risk management questionnaire as well as intelligence from other sources. We maintain regular interaction with LCs to assess their financial strength, internal controls and risk management practices.

### Breaches noted during on-site inspections

	2019/20	2018/19	2017/18
Internal control weaknesses <sup>a</sup>	451	443	535
Breach of Code of Conduct <sup>b</sup>	273	275	320
Non-compliance with anti-money laundering guidelines	331	201	175
Failure to safekeep client money	42	28	59
Failure to safekeep client securities	31	32	38
Others	361	257	349
<b>Total</b>	<b>1,489</b>	1,236	1,476

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

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

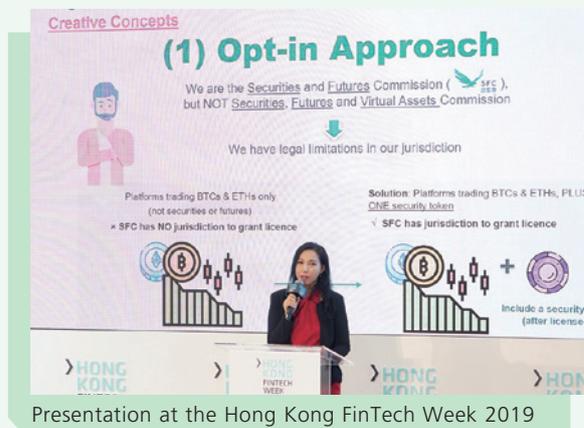
Note: See Table 4 in Breakdown of SFC activity data on page 162 for more details.

## Virtual asset trading platforms, futures and funds

On 6 November 2019, we published a licensing framework for centralised virtual asset trading platforms operating in Hong Kong which only serve professional investors and offer trading in at least one security token. We considered that it was in the public interest to introduce this framework to set standards for platforms which are willing to be licensed and compliant and at the same time give investors more choice and protect their interests.

Platform operators can apply to be licensed if they are capable of meeting regulatory standards comparable to those which apply to securities brokers and automated trading venues. However, platforms which chose not to be regulated by us would remain outside the scope of our supervision if they only offer trading in non-security tokens. We reminded investors to be aware of the risks of dealing with unregulated entities.

In a November 2019 statement, we set out our concerns about unregulated platforms offering highly leveraged virtual asset futures contracts to the public. Average investors may have difficulty understanding these complex products, and their high leverage may expose them to high risks. Further, these platforms may be illegal under the SFO or the Gambling Ordinance.



Presentation at the Hong Kong FinTech Week 2019

Given the inherent risks, licensed fund managers intending to invest in virtual assets are subject to our regulatory requirements even when managing portfolios invested solely in virtual assets which fall outside the definition of securities or futures contracts in the SFO. Accordingly, these fund managers are expected to comply with a proforma set of terms and conditions which we published in October 2019.

We will monitor developments in this evolving, dynamic industry and work with the Hong Kong Government to explore the need for legislative changes in the longer term.

## Data standard for order life cycle

We issued a circular in July 2019 to set out our standards for the minimum content and presentation format of trading data to be submitted to us upon request. This facilitates our use of new technology to better supervise securities brokers' trading behaviour by identifying irregularities which suggest potential breaches or control deficiencies. The deadline for implementing the new requirement was extended by six months to May 2021.

## SFC online portal

Starting from May 2019, intermediaries can submit notifications under the Code of Conduct<sup>5</sup> via a new service which is available on our online portal, WINGS<sup>6</sup>.

In August 2019, we launched a new platform on WINGS to collect and analyse key risk indicator (KRI) data from 22 global financial institutions which are considered systemically important. The KRI platform helps to enhance our information gathering and analytical capabilities to facilitate supervision. Effective in January 2020, LCs from these global financial institutions are required to submit KRI data regularly.

<sup>5</sup> Intermediaries must immediately report to the SFC upon the occurrence of any incident under paragraph 12.5 of the Code of Conduct.

<sup>6</sup> Web-based INteGrated Service.

## Intermediaries

### Financial Resources Rules (FRR) returns

The financial returns for LCs to report their liquid capital calculations were revised with effect from 1 April 2019, with the exception of changes related to a new accounting standard, which took effect on 1 January 2019.

To enhance our supervision of LCs, we will launch revamped FRR returns which collect additional financial and risk information periodically.

### Industry guidance

We maintain close communication with the industry and provide guidance mainly through published circulars. In survey results, thematic reports and industry newsletters, we provide examples to illustrate best practices and our regulatory concerns. When introducing a significant new regulatory measure, we hold seminars or briefings to explain and clarify our policies and expectations.

### Compliance Bulletin

The May 2019 issue of the *Compliance Bulletin* provided an update on our revamped licensing process, highlighted our efforts to track “bad apples” and stressed that the fitness and properness of an LC’s controllers and affiliates may have an impact on the firm.

The January 2020 issue emphasised the importance of sound risk management for brokers and fund managers amid market volatility and also warned investors to be cautious when investing in high-risk investment products and funds with a high concentration of illiquid assets.

### Compliance Forum

In June 2019, more than 700 industry participants attended the SFC Compliance Forum to exchange views on our guidance on securities margin financing, prime brokerage business, client onboarding and transaction monitoring as well as regulatory issues noted in selling practices. Management accountability, internal controls and supervision of account executives were also discussed.

## Statistical information and financial position of the Hong Kong securities industry

	As at 31.12.2019	As at 31.12.2018	As at 31.12.2017
Securities dealers and securities margin financiers	1,379	1,312	1,222
Active clients	2,024,849	1,874,289	1,657,931
Total assets (\$ million)	1,322,911	1,226,532	1,337,404

(\$ million)	12 months to 31.12.2019	12 months to 31.12.2018	12 months to 31.12.2017
Total value of transactions <sup>^</sup>	85,831,384	89,678,389	73,901,390
Total operating profit	11,962	23,548	23,539

<sup>^</sup> 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.

Note: Also see Table 8 in Breakdown of SFC activity data on page 165 for more details.

# Products

We authorise and regulate investment products offered to the public and monitor their ongoing compliance with regulatory requirements. We also formulate policy initiatives to develop Hong Kong as a full-service global asset and wealth management centre and a preferred fund domicile.

## Authorisations and market development

As of 31 March 2020, a total of 2,728 SFC-authorized collective investment schemes (CIS) were on offer to the public. During the year, we authorised 126 CIS, comprising 122 unit trusts and mutual funds, two mandatory provident fund (MPF) pooled investment funds, one paper gold scheme, and one real estate investment trust (REIT).

We authorised 146 unlisted structured investment products for public offering during the year.

## Authorised CIS

	As at 31.3.2020	As at 31.3.2019	As at 31.3.2018
Unit trusts and mutual funds	2,135	2,216	2,215
Investment-linked assurance schemes	299	300	299
Pooled retirement funds	33	34	34
MPF schemes	29	31	31
MPF pooled investment funds	206	191	194
Others	26 <sup>^</sup>	25	26
<b>Total</b>	<b>2,728</b>	2,797	2,799

<sup>^</sup> Comprising 14 paper gold schemes and 12 REITs.

## Unlisted structured investment products

	2019/20	2018/19	2017/18
Unlisted structured investment products <sup>a</sup>	146	130	114
Authorisations granted under section 105 of the Securities Futures Ordinance <sup>b</sup>	111	102	84

a On a "one product per key facts statement" basis, the number of unlisted structured investment products authorised during the period, most of which were equity-linked investments and deposits.

b Under section 105, offering documents and advertisements of unlisted structured investment products offered to the Hong Kong public.

<sup>1</sup> Dalian Commodity Exchange.

## ETFs and leveraged and inverse products

As of 31 March 2020, the number of SFC-authorized exchange-traded funds (ETFs) listed on The Stock Exchange of Hong Kong Limited (SEHK) was 130, including 24 leveraged and inverse (L&I) products, with total assets under management (AUM) of \$279.15 billion. Daily turnover in these ETFs averaged \$5.96 billion in the preceding 12 months.

We authorised the world's first iron ore futures ETF. It tracks the DCE<sup>1</sup> Iron Ore Futures Price Index and was listed in March 2020.

During the year, we relaxed the leverage cap for inverse products to a factor of two-times negative (-2x). We also streamlined requirements to allow an SFC-authorized feeder ETF to invest in an eligible overseas master ETF on a case-by-case basis.

## Products

We worked with SEHK to enhance the efficiency and liquidity of the ETF market. A new buy-in exemption for ETF market makers to cover short positions associated with their market making activities was introduced in July 2019. A new spread table and a continuous quoting market making regime were approved for introduction later this year.

### Open-ended fund companies

The first authorised ETF structured as a public open-ended fund company (OFC) was listed in January 2020. We also registered two private OFCs during the year.

To encourage more private funds to set up as OFCs in Hong Kong, we launched a consultation in December 2019 on proposed enhancements to the OFC regime. For private OFCs, proposals included allowing securities brokers to act as custodians and expanding the investment scope to include loans as well as shares and debentures of Hong Kong private companies.



Ms Christina Choi (right), Executive Director, Investment Products, at an awards ceremony

We also proposed a statutory mechanism for the re-domiciliation of overseas corporate funds to Hong Kong and a requirement for OFCs to keep a register of beneficial shareholders to enhance anti-money laundering and counter-terrorist financing measures.

### SFC-authorised renminbi investment products

	As at 31.3.2020
<b>Unlisted products</b>	
Unlisted funds primarily investing in the onshore Mainland securities markets or offshore renminbi bonds, fixed income instruments or other securities	58
Paper gold schemes with renminbi features	1
Recognised Mainland funds under the Mainland-Hong Kong Mutual Recognition of Funds arrangement	50
Unlisted structured investment products issued in renminbi <sup>a</sup>	146
Unlisted funds (non-renminbi denominated) with renminbi share classes	236
<b>Listed products</b>	
ETFs primarily investing in the onshore Mainland securities markets or offshore renminbi bonds, fixed income instruments or other securities	30
Renminbi gold ETFs <sup>b</sup>	1
Renminbi REITs	1
ETFs (non-renminbi denominated) with renminbi trading counters	18

a The number is on a "one product per key facts statement" basis.

b Only includes gold ETF denominated in renminbi.

## Renminbi products

As of 31 March 2020, there were 58 SFC-authorized unlisted funds<sup>2</sup> and 30 ETFs<sup>3</sup> primarily investing in the onshore Mainland securities market<sup>4</sup> or offshore renminbi bonds, fixed income instruments or other securities. The increasing number of UCITS<sup>5</sup> funds offering renminbi share classes provided more renminbi investment options in the Hong Kong market.

## Mutual market access

To broaden the investor base for Hong Kong funds and encourage the development of local investment expertise, we promote cross-border offerings of qualified Hong Kong public funds to the Mainland and other overseas markets through mutual recognition arrangements.

We signed a mutual recognition of funds (MRF) agreement with The Netherlands Authority for the Financial Markets in May 2019 which allows eligible Dutch and Hong Kong public funds to be distributed in the other market through a streamlined vetting process.

We entered into an addendum to our memorandum of understanding with the UK Financial Conduct Authority (FCA) to ensure the smooth operation of the UK-Hong Kong MRF arrangement after the UK's withdrawal from the European Union (commonly known as Brexit). In addition, we informed the market about the continuous acceptability of UK-domiciled UCITS funds as recognised jurisdiction schemes and that UK management companies with appropriate permissions from the FCA may continue to manage SFC-authorized funds post-Brexit.

## Laying a foundation for the future

We work closely with the Government and other local regulators on policies to promote Hong Kong as an onshore fund management hub and a preferred domicile for investment funds. We played an active role in recent Government-driven initiatives to establish a limited partnership regime for funds and provide tax concessions for carried interest to attract private equity funds.

We also contributed to the introduction of the new unified profits tax exemption for funds which took effect in April 2019. The exemption will apply regardless of the structure of the fund

or its size, or where its central management is located, significantly strengthening Hong Kong's competitiveness as an international fund management centre.

	Public funds	Private funds	
Policy initiatives	Broaden investor base	Facilitative measures	Collaboration with Government
	Enhance regulations	Tax incentives	
	Improve market infrastructure	Flexible legal structure	

2 Excluding recognised Mainland funds under Mainland-Hong Kong Mutual Recognition of Funds.

3 Refers to unlisted funds or ETFs which are renminbi denominated.

4 Refers to onshore Mainland investment through the Renminbi Qualified Foreign Institutional Investor, Stock Connect, Bond Connect and the China Interbank Bond Market.

5 Undertakings for collective investment in transferable securities.

## Products

During the year, we authorised the first Luxembourg UCITS fund under the Luxembourg-Hong Kong MRF scheme.

Under the Mainland-Hong Kong MRF regime, 10 Hong Kong MRF funds were approved by the China Securities Regulatory Commission during the year. As of 31 March 2020, a total of 79 funds were approved under the regime and the aggregate net subscription for both Mainland and Hong Kong MRF funds was about RMB15.6 billion.

### Asset and wealth management activities

We released the *Asset and Wealth Management Activities Survey 2018* in July 2019. To provide a more comprehensive overview of Hong Kong's asset and wealth management industry, the scope of this annual survey was extended to cover assets held by firms providing trust services in Hong Kong. The survey found that the AUM of Hong Kong's asset and wealth management business amounted to \$23,955 billion as at 31 December 2018. Net fund inflows in 2018 were \$783 billion, despite a 5% year-on-year decline in the adjusted AUM<sup>6</sup>.

### Regulatory enhancements

#### Revised UT Code

The 12-month transition period for the implementation of the revised Code on Unit Trusts and Mutual Funds (UT Code) ended on 31 December 2019. Enhanced investor protection safeguards include setting a limit for derivative usage by plain vanilla funds. For greater transparency, SFC-authorised funds are now denoted on the SFC website as derivative or non-derivative funds (ie, plain vanilla funds). As at 31 March 2020, there were 1,787 non-derivative funds and 115 derivative funds.

### Depositories of SFC-authorised funds

We launched a consultation in September 2019 on a proposed framework for a new type of regulated activity (RA 13) – acting as a depository<sup>7</sup> of an SFC-authorised CIS. Bringing depositories under our licensing, supervision and enforcement regime will provide more protection for investors in public funds.



Asset and Wealth Management Activities Survey

### FAQs

In view of the market volatility related to the COVID-19 outbreak, we issued frequently asked questions (FAQs) to allow fund managers to increase or apply a swing factor (or anti-dilution levy) exceeding the one disclosed in the funds' offering documents as a temporary measure without our prior approval, subject to certain conditions. We also reminded fund managers that they are expected to carefully consider and deploy these and other liquidity risk management tools with the primary objective of ensuring the fair treatment of all investors.

<sup>6</sup> The adjusted AUM, which amounted to \$23,047 billion as of 31 December 2018, excludes assets held under trusts by non-licensed corporations and registered institutions.

<sup>7</sup> Depositories are trustees for SFC-authorised CIS in unit trust form, and custodians at the top of the custodial chain for SFC-authorised CIS in other forms.

## Surveillance and monitoring

We monitor the risk exposure of Hong Kong domiciled SFC-authorized funds through key data reported periodically by asset managers, including subscription and redemption flows, liquidity profiles, asset allocations and securities financing and borrowing transactions.

In addition, we regularly monitor the performance of SFC-authorized funds and the market landscape. We conduct thematic surveillance focused on topical issues such as the impact of new product features and the deterioration of a particular country's or market sector's credit quality.

We also closely monitor the liquidity of SFC-authorized funds through reports from asset managers on unusual or untoward activities, including significant redemptions, suspensions of dealing and liquidity problems.

In view of the volatility and uncertainty in local and international markets, we heightened our supervision and surveillance by strengthening reporting requirements focusing on funds with large redemptions and funds' liquidity profiles. In response to the COVID-19 outbreak, we also stepped up our monitoring of locally domiciled high-yield bond funds and issued a circular to remind fund managers and



Encouraging more OFCs in Hong Kong

depositories of their obligations to properly manage the liquidity of SFC-authorized funds and ensure the fair treatment of investors under volatile market conditions.

We perform routine surveillance of advertisements and handle complaints about property-related or other suspected arrangements which may be CIS. We looked into 35 suspicious CIS cases during the year.

Message from Chairman and CEO

Strategic Priorities

Mission and Mandates

Corporate Governance

Our People

Operational Review

Corporate Developments

Corporate Social Responsibility

Financial Statements

Supplementary Information

# Green and sustainable finance

Market participants have begun to recognise that climate change and other environmental factors are a potential source of financial risk. Hong Kong is well positioned to play a leading role in the change needed to create a greener, more sustainable future, and we drive and coordinate efforts to bolster Hong Kong as a hub for green and sustainable finance in the region. During the year, we made progress in our initiatives to contribute to the development of more sustainable markets as set out in our *Strategic Framework for Green Finance* published in September 2018. To manage these initiatives and our engagement with counterparts, we now have a dedicated International Affairs and Sustainable Finance team<sup>1</sup>.



Chairman Mr Tim Lui addresses a sustainable investing conference in Hong Kong

## Asset managers

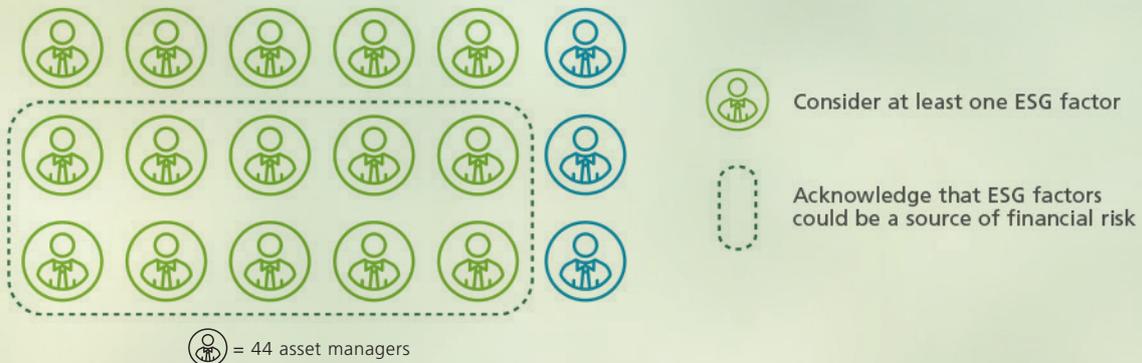
We issued a circular in April 2019 to provide guidance on enhanced disclosures by management companies of SFC-authorized green and environmental, social and governance (ESG) funds as part of our efforts to improve comparability. We also provided a central database on our website to improve the visibility of these funds.

In December 2019, we published a report on our survey on integrating ESG factors and climate risks in asset management. The majority of the active asset management firms surveyed saw ESG factors as a source of financial risk (see graphic below). However, only some consistently integrated these factors in their investment and risk management processes, and few

had measures in place to manage financial risks arising from climate change. The report also set out policy initiatives to align our regulatory regime with global standards in this area.

We established a Climate Change Technical Expert Group comprising representatives from the asset management sector, information providers, standard-setting bodies and industry associations. Members will provide technical support to help us formulate our regulatory response to manage climate change risks and provide practical guidance to the asset management industry. The group's inaugural meeting, held in March 2020, was chaired by Ms Julia Leung, our Deputy Chief Executive Officer and Executive Director, Intermediaries.

## Consideration of ESG factors by active asset managers



Source: Survey on Integrating Environmental, Social and Governance Factors and Climate Risks in Asset Management

<sup>1</sup> Formerly the International Affairs Team.



Chief Executive Officer Mr Ashley Alder at the Green Finance Regulatory Meeting hosted by the SFC

### Listed companies

We work closely with The Stock Exchange of Hong Kong Limited (SEHK) to enhance listed companies' environmental disclosure and risk management governance, with an emphasis on climate-related risks and opportunities. In May 2019, SEHK published a consultation paper on proposed changes to the ESG rules, including a new disclosure requirement for significant climate-related issues as well as mandatory disclosure of ESG governance structures. Following our approval, the rule amendments were published in December 2019 and will come into effect for financial years commencing on or after 1 July 2020.

### Regulatory collaboration

In May 2019, we hosted a meeting for senior regulators and officials from Hong Kong, the Mainland and European Union to discuss global developments in green and sustainable finance. Our Chairman Mr Tim Lui was a keynote speaker at the October 2019 Climate Finance and Sustainable Investing Conference organised by the United Nations (UN) Economic and Social Commission for Asia and the Pacific and our Chief Executive Officer Mr Ashley Alder addressed climate-related financial risks at the December 2019 UN Climate Change Summit. Other senior executives also spoke on sustainability and green finance at international and regional conferences.

We collaborate with local and overseas counterparts to support Hong Kong's role in driving efforts to reorient capital flows towards green and sustainable uses and embed sustainability in the financial sector. Ms Julia Leung leads as Vice Chair of the International Organization of Securities Commissions (IOSCO) Task Force on Sustainable Finance and sits as the IOSCO representative in the Network of Central Banks and Supervisors for Greening the Financial System.

We lead the IOSCO Asia-Pacific Regional Committee's green and sustainable finance working group which focuses on making regulation in this area more consistent as well as on ESG and climate-related disclosures and the integration of these issues in asset management. We will also join the European Commission's International Platform on Sustainable Finance.

We initiated the establishment of the Green and Sustainable Finance Cross-Agency Steering Group comprising local regulators and other authorities. Co-chaired by the SFC and the Hong Kong Monetary Authority, the group coordinates policies to develop a comprehensive green finance strategy for Hong Kong.

### Raising awareness

We work with other public bodies and industry associations to raise awareness of green and sustainable finance in the finance community. We also collaborate with the Investor and Financial Education Council (IFEC) to raise investor awareness of green finance and related investment topics through multiple channels. This year, IFEC conducted a study to assess retail investors' understanding of green finance.

### Practising sustainability

Inside the organisation, we put our commitment to a more sustainable economy into practice. Our Investment Committee monitors and enquires into how and to what extent the external managers of our financial reserves are incorporating ESG principles into their investment and risk analysis processes.



# Markets

To ensure orderly markets, we supervise and monitor exchanges, clearing houses, share registrars and automated trading services (ATS) in Hong Kong. We introduce measures to improve market infrastructure and support Hong Kong's development as a premier risk management centre.

## Supervision of HKEX

### On-site inspection

As part of our ongoing supervision of the non-listing-related operations of Hong Kong Exchanges and Clearing Limited (HKEX), we completed an on-site inspection of its futures trading and clearing operations for the period from July 2016 to June 2018 and recommended improvements.

### New products

We approved 12 derivative contracts proposed by HKEX to meet the trading and hedging needs of market participants.

## New derivative products

	Trading commencement date
<b>USD London Metal Mini Futures</b>	5 August 2019
– USD London Aluminium Mini Futures	
– USD London Zinc Mini Futures	
– USD London Copper Mini Futures	
– USD London Nickel Mini Futures	
– USD London Tin Mini Futures	
– USD London Lead Mini Futures	
<b>Weekly Index Options</b>	16 September 2019
– Weekly Hang Seng Index Options	
– Weekly Hang Seng China Enterprises Index Options	
<b>Indian Rupee Currency Futures</b>	4 November 2019
– Indian Rupee vs Renminbi (Hong Kong) Futures	
– Indian Rupee vs US Dollar Futures	
<b>Silver Futures</b>	8 June 2020
– USD Silver Futures	
– CNH Silver Futures	

## Volatility controls

To help mitigate risks caused by extreme price volatility, we worked with HKEX to review its volatility control mechanism and consider the introduction of a market-wide circuit breaker. Following an HKEX public consultation concluded in December 2019, initial enhancements to its volatility control mechanism were implemented in May 2020. The introduction of a market-wide circuit breaker is still being studied.

## After-hours futures trading session

In April 2019, we approved HKEX's proposal to extend the closing of the After-Hours Trading Session for the futures market from 1:00am to 3:00am effective 17 June 2019. The extension provides investors with more flexibility to capture investment opportunities and conduct timely risk management in response to events during European and US market hours.

## OTC derivatives

In line with the G20 commitments to reform the over-the-counter (OTC) derivatives market, an OTC derivatives regulatory regime is being implemented in phases in Hong Kong. Under the regime, reporting of OTC equity derivative transactions to the Hong Kong Trade Repository (HKTR) is mandatory (see sidebar below).

In April 2019, we launched a joint consultation with the Hong Kong Monetary Authority on enhancements to the OTC derivatives regulatory regime. We proposed

implementing unique trade identifiers and mandating their use in transactions to be submitted to the HKTR as well as narrowing the masking relief which allows for counterparty information to be redacted under certain conditions. In addition, we proposed updating the list of financial services providers as an annual exercise, and conclusions on this proposal were published in June 2019 with the revised list effective 1 January 2020.

### Market risk data

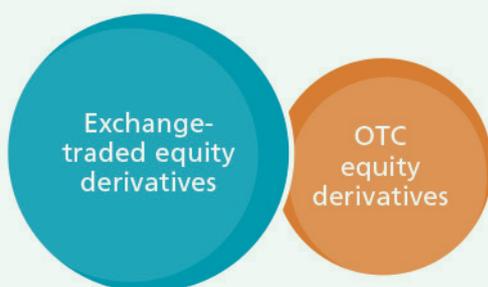
With the implementation of mandatory reporting of OTC equity derivative transactions to the HKTR in July 2017, Hong Kong is one of the first jurisdictions where comprehensive market data is available to regulators to help them assess systemic risks.

We work closely with local and overseas regulators to enhance the quality of this data. We also engage

with market participants to understand how OTC activities are reported, the nature of major transactions and the types of investors involved.

As of 31 March 2020, the market for OTC derivatives on Hong Kong equities was slightly smaller than the exchange-traded equity derivatives market. Investment banks were the major players, accounting for about half of the notional value.

#### Share of notional value



Source: HKTR

#### OTC equity derivative investors



Note: Others includes securities firms, insurers, pensions, asset managers, corporates and individuals.

## Markets

### Uncertificated securities market

In April 2020, we concluded a joint consultation with HKEX and the Federation of Share Registrars Limited on a proposed operational model for an uncertificated, or paperless, securities market in Hong Kong. This initiative will make securities-related transactions, including initial public offerings (IPOs) and corporate actions, more efficient and cost-effective by minimising paper and manual processes. Implementation is expected to commence in phases from 2022.

### Stock Connect

Since its launch in November 2014, Mainland-Hong Kong Stock Connect has opened up the Mainland equity market to the rest of the world and enabled Mainland investors to diversify portfolios outside their home market.

As of 31 March 2020, Stock Connect covered 1,288 Mainland stocks and 477 Hong Kong stocks, representing about 80% of the combined market capitalisation of the two markets. Since the programme's launch, net inflows reached RMB1,125.7 billion for southbound trading and RMB975.6 billion for northbound trading.

Stock Connect has accounted for an increasing share of Hong Kong's market turnover over time. On average, daily southbound trading reached 9% of total trading in the Hong Kong stock market during January to March 2020, compared to 6% in 2018 and 2019. Northbound trading was 5% of the Mainland market total, in line with the 4% in 2019 and higher than the 3% in 2018.

Mainland-Hong Kong Stock Connect

**RMB 1,125.7 billion**  
net inflow to Hong Kong since launch

### Investor identification

We worked with the China Securities Regulatory Commission to implement an investor identification regime for southbound trading under Stock Connect on 13 January 2020. A similar model for northbound trading was put in place in September 2018. The regime enhances market surveillance by enabling both regulators to identify the investor for each order and trade.

### Stepping up investor protection

The investor compensation regime provides a degree of compensation to investors who sustain losses in relation to Hong Kong-listed securities or futures contracts and Mainland-listed securities traded under Stock Connect, if those losses are due to the default of an intermediary in Hong Kong. The regime is reviewed regularly and updated as necessary.

To offer better protection to investors and benefit the wider market, changes to the regime took effect on 1 January 2020 following a public consultation.

### Higher compensation limit

 **\$500,000**  
per investor per default

### Expanded coverage

 includes losses relating to  
Mainland-listed securities  
traded under Stock Connect

## Investor compensation

In October 2019, we published consultation conclusions on proposals to enhance the investor compensation regime by increasing the compensation limit to \$500,000 per investor per default and extending the coverage to include northbound trading under Stock Connect (see sidebar on page 62). The changes took effect on 1 January 2020.

During the year, the Investor Compensation Company Limited, a wholly-owned SFC subsidiary, received seven claims against the Investor Compensation Fund and processed four claims.



## Investor compensation claims

	2019/20	2018/19	2017/18
Received	7	5	1
Processed	4	10	6
– Compensation payments made	0	0	3
– Rejected	0	7	3
– Withdrawn	4	2	0
– Reconsidered	0	1	0

## Net asset value of compensation funds

	As at 31.3.2020 (\$ million)	Change	As at 31.3.2019 (\$ million)	Change	As at 31.3.2018 (\$ million)
Unified Exchange Compensation Fund <sup>a</sup>	82	3.4%	79.3	4.6%	75.8
Investor Compensation Fund <sup>b</sup>	2,428.3	1.5%	2,391.5	1.3%	2,361.2
<b>Total</b>	<b>2,510.3</b>	<b>1.6%</b>	<b>2,470.8</b>	<b>1.4%</b>	<b>2,437</b>

a See pages 146-159 for the financial statements of the Unified Exchange Compensation Fund (UECF). The Investor Compensation Fund (ICF) was established by the Securities Futures Ordinance (SFO) on 1 April 2003 to replace the UECF. After settlement of all claims against the UECF and its other liabilities, any remaining balance will be transferred to the ICF.

b See pages 132-145 for the financial statements of the ICF.

## Markets

### Automated trading services

Under the SFO, two regimes regulate ATS providers. Generally, those that offer facilities similar to those of a traditional exchange or a clearing house are authorised under Part III of the SFO. Intermediaries which provide traditional dealer functions along with ATS as an added facility (eg, operating a dark pool or a pre-IPO trading platform) are expected to be licensed under Part V of the SFO.

Over the past year, we approved four Part III applications. Trades conducted on authorised trading venues were mainly in benchmark index futures and options, commodity futures, bonds, equities and exchange-traded funds offered by overseas exchanges. The average daily trading volume of futures contracts originating from Hong Kong was about 418,000 contracts for the 12 months ended 31 March 2020.

### ATS providers

	As at 31.3.2020	As at 31.3.2019	As at 31.3.2018
Under Part III	54	50	57
Under Part V	25	24	24

### Short position reporting

	As at 31.3.2020	As at 31.3.2019	As at 31.3.2018
Market value of short positions as a percentage of total market capitalisation <sup>^</sup>	1.24%	1.42%	1.43%

<sup>^</sup> Figures presented in previous reports were calculated based on market capitalisation of reported securities.

# Enforcement

Our enforcement actions focus on high-impact cases to address key risks in our financial markets. We take a proactive, front-loaded approach to enforcement which aims to punish wrongdoers, protect investors and safeguard market integrity.

## Our tools

We use the full spectrum of sanctions and remedies available to us under the Securities and Futures Ordinance (SFO), including through criminal, administrative, compensatory and disciplinary actions.

We have broad powers to hold directors and individuals responsible for misconduct committed by the companies they manage.

We can discipline licensed intermediaries through reprimands, fines<sup>1</sup> and suspensions or revocations of licences, and apply to the court for injunctive and remedial orders against wrongdoers in favour of victims.

In dealing with market misconduct, such as insider dealing and market manipulation, we can institute criminal prosecutions or bring cases directly to the Market Misconduct Tribunal (MMT).

During the year, we commenced 197 investigations and laid 10 criminal charges against six persons and one corporation and secured convictions against three persons.

We obtained disqualification and restorative orders against nine persons. Civil actions seeking financial redress and other remedial orders against 158 persons and corporations in 31 cases are pending before the court.

Disciplinary action was taken against 24 persons and 20 corporations. In addition, we commenced two cases before the MMT against one corporation and eight persons for suspected insider dealing or late disclosure of inside information. We also issued 218 compliance advice letters to address areas of regulatory concern, raise standards of conduct and promote compliance.

## Our work in figures



\* The requests were made to intermediaries as a result of our surveillance of untoward price movements and turnover.

1 Fines paid by intermediaries in disciplinary actions go into the general revenue of the Government.

## Enforcement

### Market surveillance

On a daily basis, we monitor trading on The Stock Exchange of Hong Kong Limited and the Hong Kong Futures Exchange Limited and conduct preliminary inquiries to detect possible market manipulation or insider dealing. We also engage with firms to review how they perform their monitoring and surveillance.

Through an organisation-wide Market Intelligence Programme, we use the latest technologies to identify risks in our markets, including potential misconduct by interconnected parties. Data collected from our operations and public sources is analysed to isolate patterns and connections among individuals, companies and transactions which may indicate conduct risks.

Our surveillance of untoward price and turnover movements resulted in 8,767 requests for trading and account records from intermediaries. We also received and assessed 225 notifications from intermediaries<sup>2</sup> regarding suspicious equity and derivative trading.

We posted 18 announcements on our website reminding the investing public to exercise caution when trading in shares of listed companies where a small number of shareholders hold a high concentration of shares.

### IPO sponsor failure

During the year, we took enforcement action against an initial public offering (IPO) sponsor for deficiencies in its work. We reprimanded and fined China Merchants Securities (HK) Co., Limited \$27 million in May 2019 for failing to conduct adequate due diligence on a listing applicant's largest customer, enquire into the genuineness of transactions and verify the identities of the applicant's supplier and customer representatives when conducting interviews.

### Scrutinising sponsors

Misconduct involving IPO sponsors remained one of our top enforcement priorities. Sponsors play a crucial role in ensuring the quality of Hong Kong's securities market. They coordinate the IPO process, give advice to directors and are centrally involved in the due diligence on a listing applicant.

Time and again, we have found deficiencies in sponsors' work and serious instances of non-compliance with regulatory requirements. Our enforcement actions aim to improve sponsors' due diligence standards and ensure they perform their gatekeeping role diligently, free from interference and in a professional manner. Since the launch of the new sponsor regime in October 2013, we have taken disciplinary actions against 11 sponsor firms resulting in fines totalling \$922.5 million.

This includes the record \$375 million we fined UBS AG and UBS Securities Hong Kong Limited in March 2019 for failing to verify a listing applicant's major assets and other failures. UBS Securities was also suspended from acting as an IPO sponsor. In the same month, Morgan Stanley Asia Limited and Merrill Lynch Far East Limited were reprimanded and fined for failing to address red flags in due diligence interviews and verify the identities of listing applicants' customers.

We have reminded sponsors to apply professional scepticism and address obvious red flags when discharging their gatekeeping functions. Future listing applications submitted by sponsors with a history of returned or rejected listing applications, serious deficiencies or instances of non-compliance may be subject to closer regulatory scrutiny.

<sup>2</sup> Intermediaries are required to report clients' suspected market misconduct to the SFC.



Mr Thomas Atkinson, Executive Director of Enforcement, at the Joint Case Study Workshop on Corporate Fraud and Misfeasance

## Corporate fraud and misbehaviour

### Director misconduct

We obtained disqualification and compensation orders under section 214<sup>3</sup> of the SFO in the Court of First Instance against the following company directors:

- Chin Jong Hwa, former chairman and executive director of Minth Group Limited, was ordered to pay RMB20.3 million as compensation for a subsidiary's loss due to his misconduct. Chin and three other former executive directors<sup>4</sup> were disqualified for three to six years.
- Michelle Kwok Choi Ha, former executive director of Tack Fat Group International Limited<sup>5</sup>, was disqualified for six years for failing to exercise reasonable care and diligence in managing the company and to act in good faith and in the best interests of the company.
- Wong Yuen Yee, former chairman and executive director of Inno-Tech Holdings Limited, and three other former executive directors<sup>6</sup> were disqualified for three years for failing to exercise reasonable care and diligence in the company's acquisitions of three hotels.

<sup>3</sup> Under section 214, the court may make orders to disqualify a person from being a director or being involved, directly or indirectly, in the management of any corporation for up to 15 years.

<sup>4</sup> Shi Jian Hui, Mu Wei Zhong and Zhao Feng.

<sup>5</sup> Tack Fat Group International Limited changed its name to Tack Fiori International Group Limited on 23 November 2011 and then to Life Healthcare Group Limited on 2 May 2017.

<sup>6</sup> Robert Wong Yao Wing, Wong Kwok Sing and Lam Shiu San.

<sup>7</sup> Tse Ka Wing, Liu Ka Wing, Li Shui Yan, Wong Chi Chiu and John Wong Yik Chung.

<sup>8</sup> Stephen Tang Siu Kun, She Yu Yuan, Luo Yao Wen, Cheng Wing Hong and Sun Yan.

<sup>9</sup> Formerly known as COL Capital Limited.

<sup>10</sup> Chong Sok Un, Wong Peng Chong, Kong Muk Yin, Lau Siu Ki, Ma Wah Yan and Zhang Jian.

We commenced civil proceedings under section 214 to:

- seek disqualification and compensation orders against Cheng Wai Tak, chairman and executive director of Perfect Optronics Limited, and five other directors<sup>7</sup> for alleged breach of fiduciary duties.
- seek a disqualification order against Au Yeung Ho Yin, former executive director, chief financial officer and company secretary of Fujian Nuoqi Co., Ltd., for allegedly failing to properly enquire into and alert the board about improper withdrawals of the proceeds from the company's IPO and ensure the accurate disclosure of information about their use.

The Eastern Magistrates' Courts convicted and fined Chan Wai Chuen, former chief financial officer, company secretary and an executive director of DBA Telecommunication (Asia) Holdings Limited, for his role in a false or misleading statement in the company's results announcement.

### Failure to disclose inside information

The MMT found that the following listed companies and senior executives failed to make timely disclosures of inside information:

- Health and Happiness (H&H) International Holdings Ltd and its chairman and executive director Luo Fei were fined \$1.6 million each.
- Fujikon Industrial Holdings Limited, its chairman and chief executive officer Yeung Chi Hung, and its chief financial officer and company secretary Chow Lai Fung were fined a total of \$1.5 million.
- Magic Holdings International Limited and five of its directors<sup>8</sup> were culpable of the company's failure to disclose information about L'Oréal S.A.'s proposed acquisition of Magic on a timely basis.

We commenced MMT proceedings against China Medical & HealthCare Group Limited<sup>9</sup> for allegedly failing to disclose information about significant gains in securities trading and profit figures as soon as reasonably practicable, and six former directors<sup>10</sup> for reckless or negligent conduct.

## Enforcement

### Insider dealing and market manipulation

- We commenced legal proceedings under section 213<sup>11</sup> of the SFO against a group of local and overseas individuals and corporate entities for suspected manipulation of the shares of Ching Lee Holdings Limited and obtained interim injunctions in the Court of First Instance to freeze assets of up to \$124.9 million held by 15 local and overseas entities.
- We commenced MMT proceedings against Tom Tang Chung Yen, former chairman and an executive director of Meadville Holdings Limited, and Li Yik Shuen, for alleged insider dealing in the company's shares in 2009.
- We commenced criminal proceedings against Leung Pak Keung, a practising solicitor, for alleged insider dealing in the shares of CASH Financial Services Group Limited.
- We suspended the licence of Oei Hong Eng, chairperson and a responsible officer of Gransing Securities Co., Limited, for eight months for attempting to create a false or misleading appearance of active trading in securities.
- We decided to commence proceedings for suspected market manipulation in the shares of China Ding Yi Feng Holdings Limited against a number of individuals including officers of the company. We also lifted the trading suspension of the company's shares directed by us on 8 March 2019. Trading resumed on 23 January 2020.
- The Court of Final Appeal dismissed the application of Cheng Chak Ngok, former executive director, chief financial officer and company secretary of ENN Energy Holdings Limited, for leave to appeal against the judgment of the Court of Appeal which ordered a retrial of Cheng's alleged insider dealing in the shares of China Gas Holdings Limited by the MMT.



The Eastern Magistrates' Courts convicted and fined:

- Ken Yiu Ka Lun, former senior regulatory affairs manager of Hong Kong Television Network Limited, who was sentenced to two and a half months of imprisonment and ordered to pay a fine of \$165,000 for insider dealing in the company's shares.
- Tsoi Wan, for manipulating the calculated opening price of Hang Seng Index futures contracts.

### Intermediary misconduct

During the year, we disciplined 20 corporations, nine responsible officers and 15 licensed representatives, resulting in total fines of \$479 million. Key disciplinary actions included:

#### Conflicts of interest

- We reprimanded and fined UBS AG \$400 million for overcharging its clients over a 10-year period through post-trade spread increases and excess charges and for related internal control failures.
- We reprimanded and fined RHB Securities Hong Kong Limited \$6.4 million for failing to comply with regulatory requirements for managing conflicts of interest and supervising account executives.

<sup>11</sup> Section 213 of the SFO gives the SFC the power to apply to the Court of First Instance for injunctions and other orders under specified conditions.

## Anti-money laundering related breaches

- We reprimanded and fined BMI Securities Limited \$3.7 million for failing to comply with anti-money laundering and counter-terrorist financing (AML/CFT) regulatory requirements. We also suspended the licence of its responsible officer, Maggie Tang Wing Chi, for five and a half months for failing to discharge her duties.
- We banned Tim Leissner, a former responsible officer of Goldman Sachs (Asia) L.L.C., from re-entering the industry for life following his conviction for conspiring to commit money laundering and violate the US Foreign Corrupt Practices Act.

- We banned Su Xiqiang, former head of retail brokerage and responsible officer of Guosen Securities (HK) Brokerage Company, Limited, from re-entering the industry for 10 months for failing to ensure the company's compliance with AML/CFT regulatory requirements when handling third-party fund deposits.

## Window-dressing liquid capital

- We banned Ang Wing Fung, former chairman of W. Falcon Asset Management (Asia) Limited, and Chan Kam Wah, former chief financial officer and company secretary, from re-entering the industry for life and three years respectively, in connection with their roles in window-dressing Falcon's liquid capital. Falcon's licence was revoked in February 2019.

## Other disciplinary actions

### Reprimanded and fined for internal control failures

Company	Breaches	Fine	Date
China Rise Securities Asset Management Company Limited <sup>^</sup>	Internal control failures and regulatory breaches in short selling orders, cross trades and record keeping	\$6.3 million	31.10.2019
The Hongkong and Shanghai Banking Corporation Limited	Ineffective internal control procedures to ensure compliance with the telephone recording requirements	\$2.1 million	10.9.2019
Sincere Securities Limited	Deficiencies in business operations, internal controls and procedures	\$5 million	15.8.2019
Glory Sun Securities Limited	Failure to diligently supervise account executives and implement effective controls to comply with short selling requirements	\$1.2 million	15.7.2019
Lee's Securities Company Limited	Internal control failures in the segregation of duties and handling of client securities	\$520,000	15.7.2019
Celestial Commodities Limited	Regulatory breaches and internal control failings relating to mishandling client money	\$4.9 million	10.7.2019
Celestial Securities Limited		\$1.4 million	
China Merchants Securities (HK) Co., Limited	Regulatory breaches and internal control failings relating to mishandling client money	\$5 million	30.5.2019

<sup>^</sup> Formerly known as China Rise Securities Company Limited.

## Enforcement

### Disciplined for conviction of bribery or theft

Name	Breaches	Action	Date
Mo Chau Wah	Stealing and selling clients' shares worth over \$110 million	Banned from re-entering the industry for life	23.3.2020
Ma Sin Chi	Accepting bribes of around \$6.4 million from a client	Banned from re-entering the industry for life	14.11.2019
Ye Feng	Soliciting illegal commission payments of more than \$900,000 from a client	Banned from re-entering the industry for life	23.9.2019
Tu Bing	Soliciting and accepting illegal commission payments of approximately \$1.4 million from a client	Banned from re-entering the industry for life	5.8.2019

### Reprimanded and fined for other regulatory breaches

Company	Breaches	Fine	Date
Capital Global Management Limited	Failing to comply with laws and regulations in distributing investment funds and offering investment advice in Taiwan, and to adequately supervise its representatives' business activities	\$1.5 million	14.2.2020
FIL Investment Management (Hong Kong) Limited	Unlicensed dealing in futures contracts, delay in reporting the breach to the SFC and submitting incorrect information in a new fund authorisation application	\$3.5 million	30.12.2019
Adamas Asset Management (HK) Limited	Failing to implement adequate measures to ensure proper disclosure of notifiable interests in the shares of Hong Kong-listed companies held in client portfolios	\$2.5 million	23.12.2019
SEAVI Advent Ocean Private Equity Limited	Allowing unlicensed employees to perform regulated activities	\$1 million	3.10.2019
FT Securities Limited	Regulatory breaches and internal control failures in the preparation and publication of research reports	\$3.5 million	24.6.2019
Credit Suisse (Hong Kong) Limited and Credit Suisse AG	Failing to comply with disclosure requirements for publishing research reports	\$2.8 million	19.6.2019
Nine Masts Capital Limited	Naked short selling of the shares of Yuzhou Properties Company Limited	\$1.2 million	18.4.2019

Note: See Table 6 in Breakdown of SFC activity data on page 163 for details of other disciplinary actions.

## Other notable cases

- The Court of First Instance dismissed judicial review applications against the SFC<sup>12</sup> in connection with a search operation it conducted for ongoing investigations.
- The Court of Appeal dismissed the application of Andrew Left of Citron Research for leave to appeal to the Court of Final Appeal against the determinations of the MMT<sup>13</sup>.

- The Eastern Magistrates' Courts convicted Yau Ka Fai for holding himself out as carrying on a business in asset management without an SFC licence.
- We commenced criminal proceedings against Brilliance Capital Management Limited and its sole director Law Sai Hung for holding out as carrying on a business in advising on corporate finance without an SFC licence.

## Cooperation with ICAC

During the year, we strengthened our strategic cooperation with the Independent Commission Against Corruption (ICAC) to leverage our collective expertise and powers. This helps achieve our shared goal of maintaining the reputation and integrity of Hong Kong as a clean and trusted international financial centre free from corrupt practices. We held numerous meetings with ICAC to discuss both strategic and case-specific matters.

Between May and July 2019, the ICAC charged four former executive directors of Convoy Global Holdings Limited and two others with conspiracy to defraud.



Joint investigation training workshop



Signing of MoU with ICAC

The charges followed our joint operation with the ICAC involving the company and demonstrate the benefit of harnessing our combined expertise to fight financial crime.

In August 2019, we entered into a memorandum of understanding (MoU) with the ICAC to formalise our cooperation arrangements. The MoU lays out a framework for the mutual provision of investigative assistance, capacity building and case referrals as well as the exchange of information between the two organisations.

Subsequently, we hosted a joint training workshop for investigators to share their expertise and experience in tackling serious financial crime.

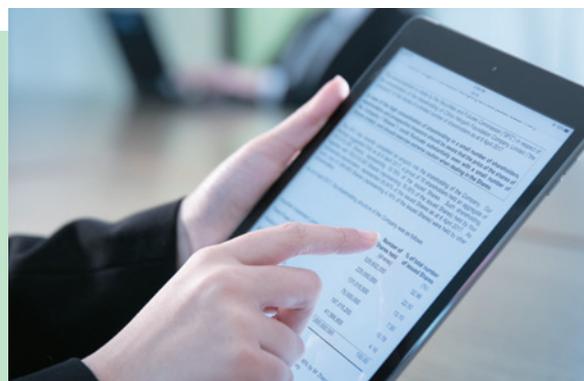
<sup>12</sup> In the applications, Cyril Cheung Ka Ho, To Hang Ming, To Lung Sang, Jacky To Man Choy and Wan Wai Lun sought to challenge search warrants issued by two Magistrates in July 2018 on the basis that they were unlawful or invalid for want of specificity.

<sup>13</sup> On 26 August 2016, the MMT found Andrew Left culpable of disclosing false or misleading information inducing transactions in a report on Evergrande Real Estate Group Limited published in June 2012.

## Enforcement

### Restriction notices

During the year, we issued restriction notices to 21 brokers prohibiting them from dealing with or processing assets held in client accounts. The assets are related to suspected market manipulation in the shares of three listed companies, suspected breach of duties by an individual towards a listed company and other misconduct. One of the brokers, Hong Kong Wan Kiu Investment Company Limited, was also prohibited from carrying on regulated activities for which it is licensed.



### Enforcement activities

	2019/20	2018/19	2017/18
S179 <sup>a</sup> inquiries commenced	31	26	24
S181 <sup>b</sup> inquiries commenced (number of letters sent)	231 (8,767)	294 (9,074)	261 (8,461)
S182 <sup>c</sup> directions issued	187	231	274
Investigations started	197	238	280
Investigations completed	182	243	254
Individuals / corporations charged in criminal proceedings	7	5	14
Criminal charges laid <sup>d</sup>	10	42	54
Notices of Proposed Disciplinary Action <sup>e</sup> issued	35	22	29
Notices of Decisions <sup>f</sup> issued	46	34	32
Individuals / corporations subject to ongoing civil proceedings	158	101	97
Compliance advice letters issued	218	234	277
Cases with search warrants executed	17	30	22

a Section 179 of the SFO gives the SFC the power to compel the production of records and documents from persons related to a listed company in relation to fraud or other misconduct.

b Section 181 of the SFO gives the SFC the power to require information from intermediaries about trading transactions, including the identity information of the ultimate clients, the particulars and instructions relating to the transactions.

c Section 182 of the SFO gives the SFC the power to investigate SFO offences, market misconduct, fraud, misfeasance and disciplinary misconduct.

d The SFC brought a total of 10 criminal charges against six individuals and one corporation.

e A notice issued by the SFC to regulated persons that it proposes to exercise its disciplinary powers, on grounds that they appear to be guilty of misconduct or not fit and proper.

f A notice that sets out the SFC's decision and its reasons to take disciplinary action against regulated persons.

Note: Also see Table 7 in Breakdown of SFC activity data on page 164 for more details.

# Regulatory engagement

We participate in international policymaking through our involvement in global standard-setting bodies and collaborate closely with local and Mainland authorities on regulatory and market development initiatives.

## International

### IOSCO

We play an active role in the International Organization of Securities Commissions (IOSCO), which develops, implements and promotes adherence to internationally-recognised standards for securities regulation. We work closely with the IOSCO Secretariat to develop policy initiatives, facilitate collaboration between IOSCO and the Financial Stability Board (FSB) and promote interaction between members from emerging and developed economies.

Our Chief Executive Officer Mr Ashley Alder has served as Chairman of the IOSCO Board since May 2016. During his tenure, he has advanced IOSCO's priorities related to sustainable finance, structural vulnerabilities in asset management, market fragmentation and financial technologies (Fintech).

Mr Alder also co-chaired the CPMI<sup>1</sup>-IOSCO Steering Group, which coordinated regulatory policy work including the oversight and supervision of central counterparties and monitoring of the implementation of the Principles for Financial Market Infrastructures.

Our Chairman Mr Tim Lui participated in the IOSCO Asia-Pacific Regional Committee (APRC) meeting in October 2019, which discussed supervisory cooperation, sustainable finance and market conduct issues.

Also in October, Mr Alder participated in the European Union (EU)-Asia Pacific Forum where discussions continued between the European Commission, European Securities and Markets Authority and members of the IOSCO APRC on cross-border regulatory issues arising out of EU regulations. Topics included sustainable finance, crypto-assets, market fragmentation risks and EU regulations and proposals which may have an impact on the Asia Pacific region.



Chief Executive Officer Mr Ashley Alder at the May 2019 IOSCO annual conference

*Photo: IOSCO General Secretariat*

We participate in all eight IOSCO policy committees as well as the Committee on Emerging Risks, Assessment Committee, Sustainable Finance Network, Fintech Network and key task forces and working groups. We also lead the APRC working group on sustainable finance, a regional platform to support information sharing and capacity building with a focus on climate-related risk.

- We participated in the Committee on Regulation of Market Intermediaries' working group which examined conflicts of interest and conduct risks in the debt capital raising process for corporate bonds. A consultation report was published in December 2019.
- We chair the Committee on Investment Management exchange-traded fund (ETF) working group and participate in the index provider working group. We also contributed to IOSCO's *Final Report on Recommendations for a Framework Assessing Leverage in Investment Funds*.

### FSB

As Chairman of the IOSCO Board, Mr Alder participated in the FSB's Plenary and its Steering Committee meetings. The January 2020 meeting focused on monitoring the progress of the G20 reforms, financial vulnerabilities in the global financial system and non-bank financial intermediation.

1 Committee on Payments and Market Infrastructures.

## Regulatory engagement

We are a member of the FSB Standing Committee on Standards Implementation and contributed to its Implementation Monitoring Network, which considers the effects of the G20 reforms and conducts thematic monitoring and peer reviews. We worked with the Hong Kong Monetary Authority, the Insurance Authority and the Financial Services and the Treasury Bureau on the FSB's annual exercise to monitor the implementation of the G20 reforms.

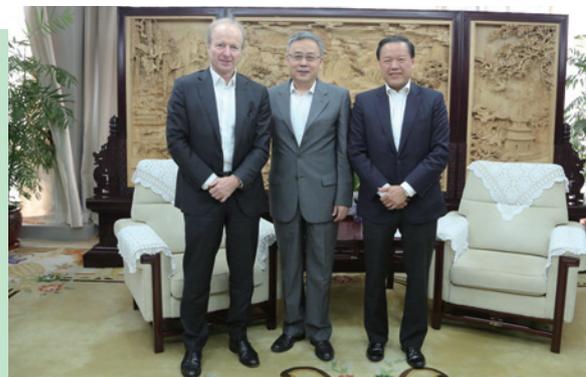
We are a member of the FSB Regional Consultative Group for Asia, to which we contribute views on regulatory policy, and the Cross-Border Crisis Management Group for Financial Market Infrastructures, which monitors and promotes the implementation of resolution regimes for central counterparties. We also participate in FSB workstreams and exercises such as the survey on non-bank financial intermediation.

### Mainland China

To advance Hong Kong's unique position as the international financial centre connecting Mainland and international capital flows, we take an active part in Mainland-Hong Kong cooperation initiatives and hold regular discussions with the China Securities Regulatory Commission (CSRC) to enhance our supervisory and regulatory cooperation. The fifth biannual SFC-CSRC high-level meeting was held in May 2019 in Hong Kong and the sixth was held in November 2019 in Shenzhen.



Meeting with PBoC and SAFE officials



From left: Mr Ashley Alder, Chief Executive Officer, Mr Guo Shuqing, CBIRC Chairman, and Mr Tim Lui, Chairman

In July 2019, Mr Lui and Mr Alder met Mr Guo Shuqing, Chairman of the China Banking and Insurance Regulatory Commission (CBIRC), in Beijing to discuss collaboration between the SFC and the CBIRC, particularly in the supervision of Hong Kong subsidiaries of Mainland banks and insurance companies.

We met with the People's Bank of China (PBoC) and State Administration of Foreign Exchange (SAFE) and received visitors from the National Development and Reform Commission to exchange views on market development and cooperation initiatives. We also engaged with Mainland exchanges and clearing houses to discuss their operations in Hong Kong and the further opening-up of the Mainland capital market.

We organise training programmes and seminars for executives from Mainland authorities and businesses to better understand the Hong Kong securities market and our regulatory framework. We shared Hong Kong's experience in regulating leveraged foreign exchange trading at a SAFE-World Bank Roundtable in April 2019 and spoke at a Securities Association of China seminar in October 2019.

In July 2019, we entered into a tripartite Memorandum of Understanding with the Ministry of Finance of the People's Republic of China and the CSRC on access to audit working papers for Hong Kong-listed Mainland companies.

We support the HKSAR Government in strengthening cooperative relationships with Mainland authorities to develop Hong Kong's financial services sector and access to Mainland markets. We participated in the formulation and negotiation of amendments to the Agreement on Trade in Services of the Mainland and Hong Kong Closer Economic Partnership Arrangement, signed in November 2019, which provide new business opportunities for Hong Kong's financial industry. We also work closely with Mainland authorities to implement initiatives set out in the Greater Bay Area development plan.

### Other engagement

During the year, we maintained regular dialogue with other regulators to share information about global financial institutions. We attended supervisory meetings hosted by the Swiss Financial Market Supervisory Authority in Hong Kong and Zurich, where

Swiss-headquartered global banks provided updates on their internal controls and monitoring programmes, as well as supervisory colleges for US-headquartered investment banks hosted in New York and London by the US Federal Reserve.

We also attended supervisory meetings jointly hosted by the Australian Prudential Regulation Authority and Australian Securities and Investments Commission in June 2019, as well as a meeting organised by Japan's Financial Services Agency in February 2020, to share regulatory experience and enhance the cross-border monitoring of financial institutions.

In November 2019, we held the eleventh Bilateral Regulatory Meeting with the Taiwan Financial Supervisory Commission where we exchanged views on the regulation of virtual assets, bond ETFs and real estate investment trusts.

### Requests for regulatory cooperation

	2019/20		2018/19		2017/18	
	Received	Made	Received	Made	Received	Made
Enforcement-related requests for assistance	103	95	113	99	136	104
Licensing-related requests for assistance	143	18	121	597	112	1,178

# Stakeholders

To promote a wider understanding of our work and provide up-to-date regulatory information, we conduct timely, concerted outreach with a wide range of stakeholders.

## Industry

We maintain an open and productive dialogue with industry associations, professional bodies and other market participants. We organise regular meetings and briefings and from time to time contribute articles to industry association newsletters to keep market participants informed about regulatory developments.

The SFC Compliance Forum 2019<sup>1</sup>, held in June, was attended by more than 700 industry participants. We also hosted three half-day seminars during the year for over 800 management and compliance personnel from licensed corporations to present the findings of the Financial Action Task Force's *Mutual Evaluation Report of Hong Kong*, provide an update on regulatory developments and share inspection findings and other supervisory observations related to anti-money laundering and counter-terrorist financing.

To introduce the new guidelines for securities margin financing activities, we briefed over 100 industry participants and posted an e-learning video on our website. About 1,000 industry participants attended our seminars on the implementation of new requirements for the sale of complex products.



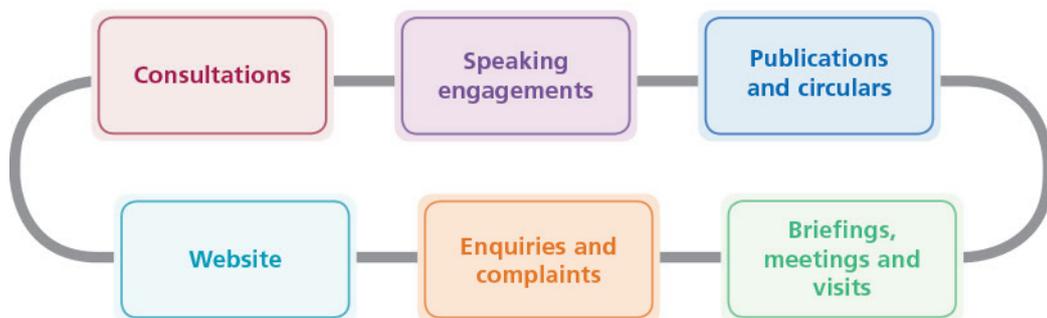
Chairman Mr Tim Lui at the Financial Services Development Council's Career Day 2019

We gave presentations focusing on private equity firms and family offices for two industry associations, Mainland fund managers and the Asian Financial Forum 2020.

During the year, our senior executives took part in 103 speaking engagements on a wide range of topics within our remit, including listing regulation, asset management and financial technology (Fintech). We supported 11 seminars or events organised by industry bodies.

In November, the SFC supported the Hong Kong FinTech Week 2019 Main Conference as a regulatory partner. Our senior executives discussed the regulation of virtual asset trading platforms at the event.

## Stakeholder communication channels



<sup>1</sup> See Intermediaries on pages 46-52.



Chief Executive Officer Mr Ashley Alder at Hong Kong FinTech Week 2019

When proposing rules under the Securities and Futures Ordinance, we consistently exceed statutory requirements for public consultation. We consult the public on proposed non-statutory codes and guidelines, as well as amendments to them. We issue consultation papers to detail our proposals and hold both formal and informal discussions to hear stakeholders' views as part of our consultation process.

After completing our analysis, we issue a consultation conclusions paper summarising the main comments received and setting out our conclusions. A total of four consultation papers and four consultation conclusions were published in the year.

## Publications and other communications

	2019/20	2018/19	2017/18
Press releases	123	128	138
Policy statements and announcements	8	3	3
Consultation papers	4	5	11
Consultation conclusions	4	11	8
Industry-related publications	15	15	15
Codes and guidelines <sup>a</sup>	5	14	10
Circulars to industry	73	90	83
Corporate website average daily page views <sup>b</sup>	42,816	64,947	67,664
General enquiries	6,037	6,709	7,494

a Includes updates to previous versions.

b The average number of webpages browsed per day during the reporting period.

Our publications aim to update the industry on our regulatory work, topical issues and other developments. This year, we issued 15 thematic publications, including newsletters, market reviews and surveys. We also published a pamphlet to introduce open-ended funds, a new corporate investment fund vehicle in Hong Kong.

To help the industry better understand our regulatory requirements, we issue circulars and frequently-asked questions which we post on the SFC website. During the year, we published 73 circulars on various topics, including protection of client assets, client facilitation, third-party deposits and payments, complex financing arrangements, mutual recognition of funds and updates on anti-money laundering and counter-terrorist financing.

We respond verbally or in writing to enquiries from the industry on topics related to our rules and regulations, ranging from licensing, listings and takeovers matters, and product authorisation to short position reporting.

To help us handle enquiries on specific topics more efficiently, designated e-mailboxes are provided. The SFC Fintech Contact Point promotes communication with businesses involved in the development and application of financial technology in the conduct of regulated activities in Hong Kong.

## Stakeholders

### Government

By attending Legislative Council (LegCo) meetings, including meetings of the Panel on Financial Affairs and relevant Bills Committees, we provide legislators with details of our policy initiatives, explain the rationale behind our work and answer questions. We also respond to enquiries and complaints referred to us or raised by LegCo members and other government agencies.

In addition, we maintain close liaison with the Financial Services and the Treasury Bureau and provide updates on our regulatory initiatives through regular meetings and reports. We provide assistance and information to other government bureaux and departments on various issues.



Ms Julia Leung, Deputy Chief Executive Officer and Executive Director of Intermediaries, at Asian Financial Forum 2020

### Regulatory counterparts

We are active in international regulatory cooperation. We participate in both the International Organization of Securities Commissions and the Financial Stability Board<sup>2</sup>.

We maintain close contact with local, Mainland and overseas regulatory counterparts. During the year, we signed four memoranda of understanding (MoU) with other authorities and exchanges and held 83 MoU meetings. We also received visitors and delegates from Mainland and overseas authorities.

<sup>2</sup> See Regulatory engagement on pages 73-75.

<sup>3</sup> One case may comprise multiple complaints.

<sup>4</sup> Hong Kong Exchanges and Clearing Limited.

In May 2019, we hosted a high-level regulatory meeting in Hong Kong for senior officials from the Mainland, Hong Kong and the European Union to discuss the harmonisation of green finance efforts and standards.

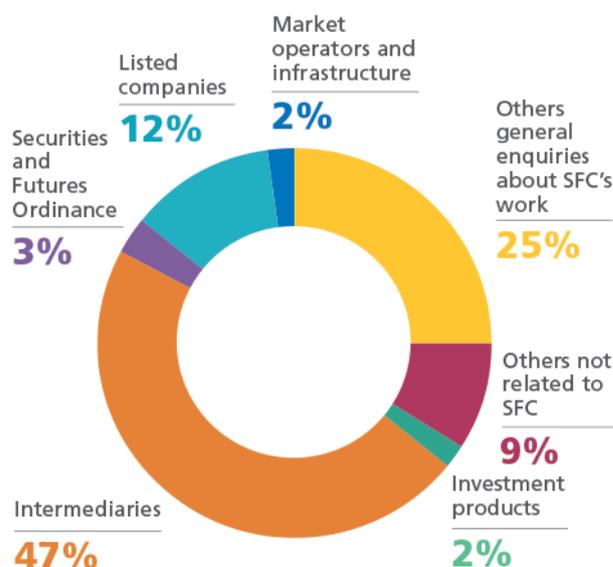
### The public

We address public concerns and enquiries regarding the securities and futures markets. This year, we received a total of 6,037 general enquiries by phone or in writing.

We handled 4,491 complaints during the year. Complaints against intermediaries and market activities are first reviewed by our Complaints Control Committee, which comprises senior executives from across the organisation, and are allocated to responsible divisions for assessment where appropriate.

A total of 1,419 cases<sup>3</sup> were allocated for further review and 509 were referred to HKEX<sup>4</sup>, other financial regulators or law enforcement agencies.

### General enquiries



To increase public understanding of Hong Kong's financial regulatory framework and our role in it, we received visitors from local and overseas institutions and our senior executives gave media interviews. We issued 123 press releases to inform the public of the latest regulatory actions and other SFC news. We also published eight policy statements and announcements explaining our regulatory approach to specific issues, such as backdoor listings and virtual asset trading platforms, and providing guidance in areas of concern.

We released our *Annual Report 2018-19* and quarterly reports to help stakeholders understand our work. Our reporting efforts were recognised with a Gold Award and a Sustainability Reporting Award in the Hong Kong Management Association's Best Annual Reports Awards 2019. The report also won a Special Mention Award, public sector category, in the Hong Kong Institute of Certified Public Accountants' Best Corporate Governance Awards 2019.



Our executives at a regulatory seminar hosted by The Hong Kong Institute of Chartered Secretaries

The public can easily obtain up-to-date information about our work and regulations on our corporate website, which was updated and enhanced during the year to make it easier for users to find information.

## Complaints against intermediaries and market activities

	2019/20	2018/19	2017/18
Conduct of licensees	583	453	357
Conduct of registered institutions	27	16	22
Listing-related matters and disclosure of interests	2,065	3,485	779
Market misconduct <sup>a</sup>	478	364	322
Product disclosure	14	8	12
Unlicensed activities	176	164	141
Breach of offers of investments	98	30	48
Boiler rooms and suspicious websites	486	378	319
Scams and frauds <sup>b</sup>	276	285	186
Other financial activities not regulated by SFC <sup>c</sup>	288	851	503
<b>Total</b>	<b>4,491</b>	<b>6,034</b>	<b>2,689</b>

a Primarily, alleged market manipulation and insider dealing.

b Such as identity fraud and impersonation.

c For example, bullion trading, banking complaints.

Message from Chairman and CEO

Strategic Priorities

Mission and Mandates

Corporate Governance

Our People

Operational Review

Corporate Developments

Corporate Social Responsibility

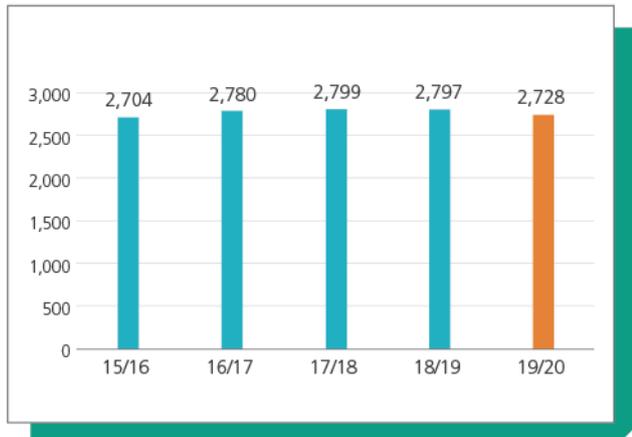
Financial Statements

Supplementary Information

# SFC activity data

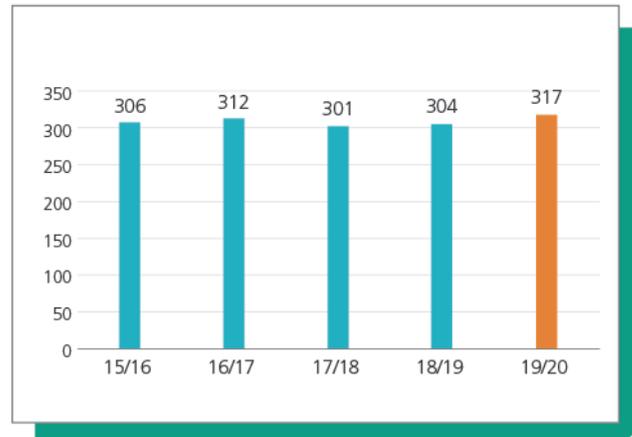
These charts are intended to show at a glance some top-line data on our activities. See Breakdown of SFC activity data on pages 160-165 for more details.

## Authorised collective investment schemes

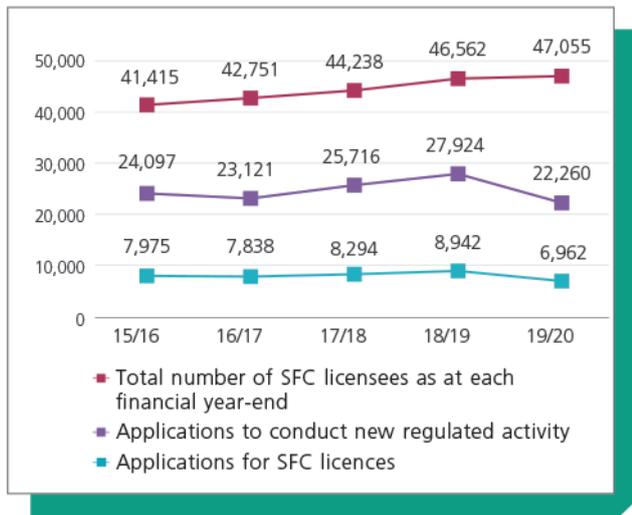


Note: Figures represent a snapshot view as at each financial year-end.

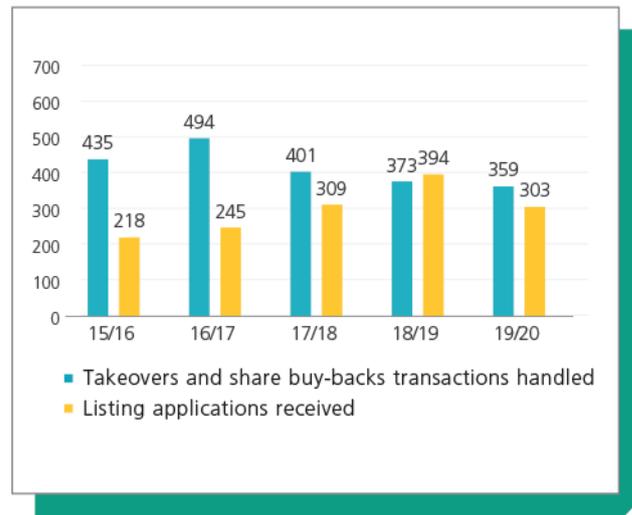
## On-site inspections of intermediaries



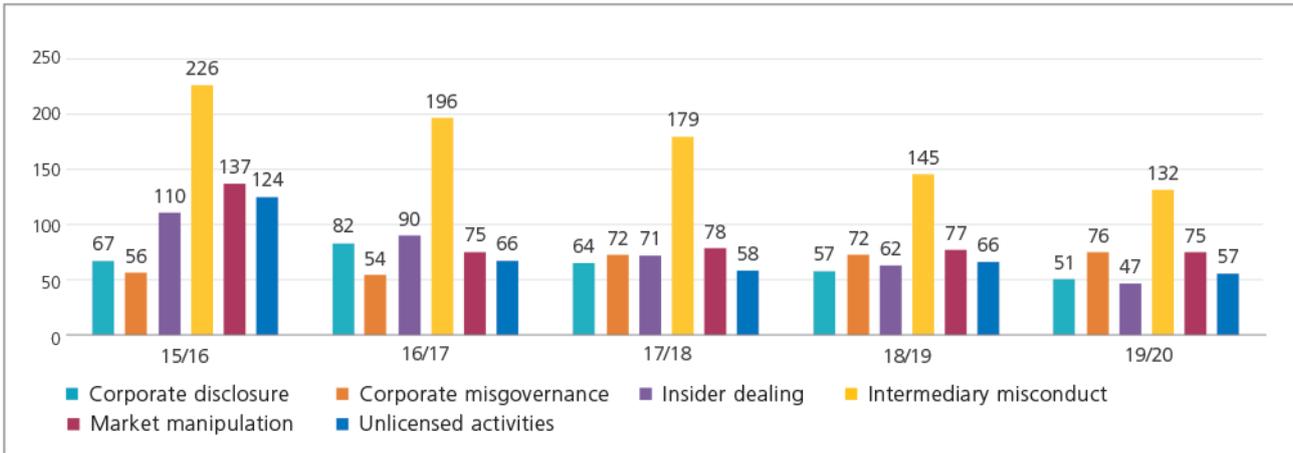
## Licensing



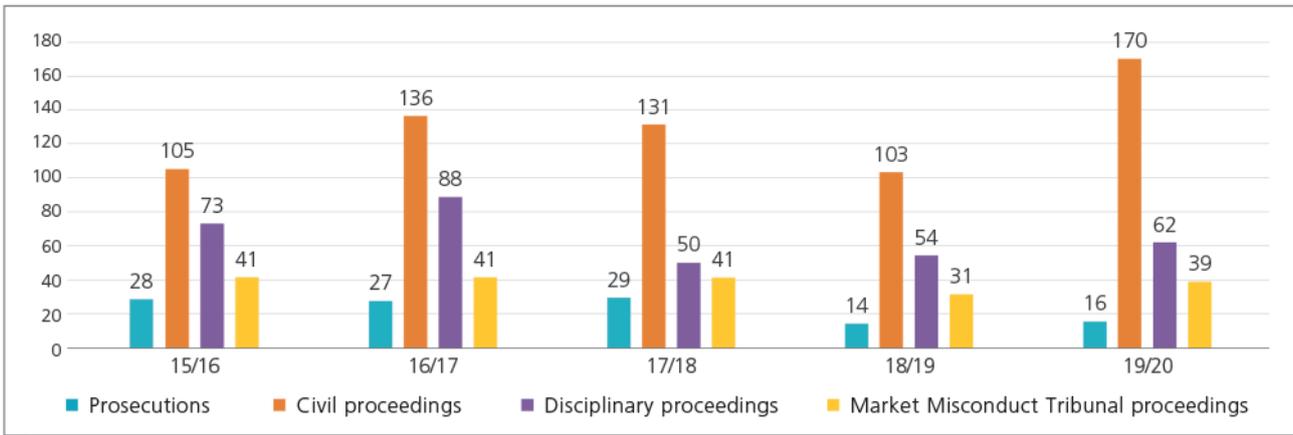
## Takeovers and listing applications



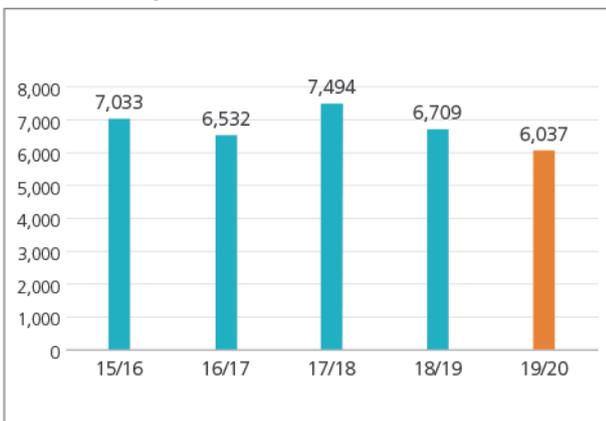
### Investigations



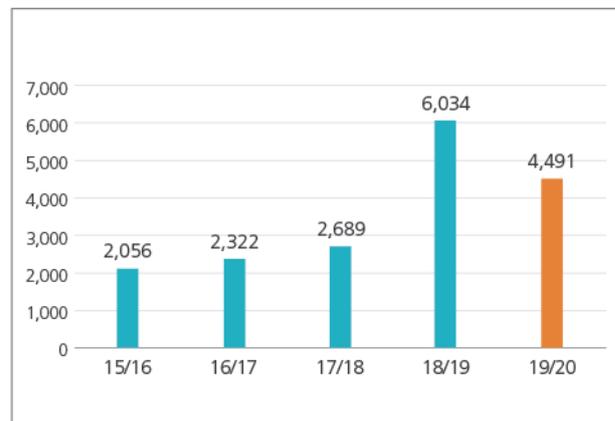
### Persons/corporations subject to enforcement action



### General enquiries



### Complaints against intermediaries and market activities



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