

Operational Review

We endeavour to ensure stability, competitiveness and orderliness in the financial markets through our principal areas of work: intermediaries, investment products, listings and takeovers, market infrastructure and trading, and enforcement.

Intermediaries

We license qualified corporations and individuals 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 corporations¹ and explain our regulatory focus and concerns to the industry. We closely monitor market and technological developments and adapt our approach accordingly.

Licensing

We received 8,294 new licence applications during the year, an increase of 6% from a year earlier. As of 31 March 2018, the number of licensees and registrants totalled 44,358, up 3% from last year, while the number of licensed corporations increased 9% to 2,702 in the same period. These were both record highs since the implementation of the regulatory regime under the SFO on 1 April 2003.

We extended the annual licence fee waiver for one year to 31 March 2019.

Regulatory enhancements

Senior management accountability

The Manager-In-Charge (MIC) regime for licensed corporations was fully implemented on 16 October 2017 following a six-month transition period (see sidebar on page 41).

Also on 16 October 2017, the Hong Kong Monetary Authority (HKMA) issued a circular requiring registered institutions to submit their up-to-date management structure information and organisational charts to both the HKMA and the SFC by April 2018.

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

Intermediaries

Suitability obligations

To provide tailored guidance to the industry on the design and operation of online platforms and clarify how the suitability requirement would operate in an online environment, we concluded a public consultation in March 2018 on proposed guidelines for online distribution and advisory platforms. The guidelines will become effective in April 2019. We also launched a further consultation on requirements applicable to the offline sale of complex products.

In a January 2018 circular, we reminded intermediaries of their obligations to comply with the suitability requirement and in particular about the SFC's expected standards for product due diligence, measures to identify whether the suitability obligation has been triggered, assessments of suitability frameworks and the retention of compliance records.

Cybersecurity

To reduce and mitigate hacking risks associated with internet trading, we launched a two-month public consultation in May 2017. Subsequently, we held cybersecurity awareness workshops and presentations for licensed corporations including two workshops co-hosted with the Hong Kong Police and Hong Kong Computer Emergency Response Team Coordination Centre.

Upon concluding the consultation in October 2017, we issued guidelines on cybersecurity baseline requirements, including two-factor authentication for system login, along with a circular on good industry practices for cybersecurity and information technology risk management. The two-factor authentication requirement took effect on 27 April 2018 and other requirements will become effective on 27 July 2018.

Asset managers

Following the publication of consultation conclusions in November 2017, enhancements to asset management regulation in light of international developments will take effect in November 2018 and enhancements to point-of-sale transparency to better address conflicts of interest in the sale of investment products will become effective in August 2018. A further consultation on disclosure requirements applicable to discretionary accounts was concluded in May 2018.

In view of the growing number of firms licensed for asset management activities, we issued circulars in July and September 2017 to highlight irregularities and common instances of non-compliance in managing funds and discretionary accounts. Asset managers were reminded of the SFC's expected standards, including to perform their roles responsibly with due skill, care and diligence, in the best interests of their clients and the integrity of the market.

Licenseses

	Corporations [^]		Representatives		Responsible Officers		Total [^]		
	As at 31.3.2018	As at 31.3.2017	As at 31.3.2018	As at 31.3.2017	As at 31.3.2018	As at 31.3.2017	As at 31.3.2018	As at 31.3.2017	Change
Stock exchange participants	563	512	12,096	11,068	2,043	1,830	14,702	13,410	9.6%
Futures exchange participants	115	112	884	921	188	196	1,187	1,229	-3.4%
Stock exchange and futures exchange participants	74	69	4,831	4,914	536	522	5,441	5,505	-1.2%
Non-stock/non-futures exchange participants	1,950	1,791	15,784	16,086	5,174	4,730	22,908	22,607	1.3%
Total	2,702	2,484	33,595	32,989	7,941	7,278	44,238	42,751	3.5%

[^] These figures exclude 120 registered institutions as at 31 March 2018 and 121 as at 31 March 2017.

MIC regime

The objective of the MIC regime is to heighten awareness of senior management accountability and enhance corporate governance. Under the regime, licensed firms are required to submit management structure information, including about MICs of eight core functions and organisational charts, in a standardised format. MICs of overall management oversight (OMO) and key business line (KBL) are

expected to be responsible officers (ROs) in respect of the regulated activities they oversee.

Since the launch of the MIC regime, many firms have taken concrete measures to enhance their governance structures, including strengthening the composition of their boards, clearly delineating the job responsibilities and reporting lines of individual senior managers and better aligning senior management accountability with the RO regime.

10,600
MICs

62%
of MICs are licensees

2,000
RO applications from
MICs of OMO or KBL

Note: Data as of 31 March 2018. Some MICs are not required to be licensed because they do not conduct regulated activities. They are primarily responsible for managing operations or control functions such as compliance, risk management, finance, information technology and anti-money laundering.

Over-the-counter derivatives

As part of comprehensive reforms to enhance Hong Kong's regulatory regime for over-the-counter (OTC) derivatives activities and to strengthen the management of conduct and financial risks in transactions and business dealings with related parties, we launched a public consultation in December 2017 on proposed refinements to the scope of regulated activities under the OTC derivatives regime. Other proposals related to licensing fees, insurance, competence and training requirements under the regime and, more broadly, requirements for licensed corporations to properly manage financial exposures to group affiliates and other connected persons.

Financial Resources Rules

In July 2017, we published consultation conclusions on the proposed regulatory capital regime for licensed corporations engaged in OTC derivatives activities and other changes to the Securities and Futures (Financial Resources) Rules (FRR). In parallel, we further consulted on a number of modified and additional proposals as well as draft FRR amendments which are not specific to OTC derivatives activities.

Financial resolution regime

The financial resolution regime under the Financial Institutions (Resolution) Ordinance, which came into operation on 7 July 2017, vests the SFC with powers to effect the orderly resolution of certain licensed corporations.

We worked with the HKMA, the Insurance Authority and the Financial Services and the Treasury Bureau on the 2017 Financial Stability Board Peer Review which examined the framework for the resolution of financial institutions in Hong Kong.

Anti-money laundering

In February 2018, we gazetted revised guidelines to incorporate provisions reflecting the amendments in the recently enacted Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018. A circular was issued on the same day to draw licensed corporations and affiliates' attention to the need to review their existing policies and procedures and ensure continued compliance. The revised guidelines came into effect in March 2018.

Intermediaries

Credit rating agencies

After assessing information provided by the SFC, the European Securities and Markets Authority announced in November 2017 that Hong Kong would retain its status as one of the equivalence jurisdictions for credit rating agencies (CRA) under the new requirements in the European Union (EU) CRA Regulation effective 1 June 2018. Accordingly, financial institutions in the EU may continue to use credit ratings prepared by SFC-licensed CRAs for regulatory purposes.

Monitoring compliance

We employ various tools, including on-site reviews and off-site monitoring, in supervising licensed corporations with a focus on their financial risks and how they conduct business.

On-site reviews

On-site reviews, which include prudential visits and routine, special and thematic inspections, are a key supervisory tool for understanding a firm's business operations, risk management and internal controls and gauging its compliance with legal and regulatory requirements. This includes assessing whether it acts with due skill, care and diligence and adopts proper business conduct, procedures and practices.

During the year, we conducted 301 risk-based on-site inspections, including thematic inspections on a range of issues. We enhanced our case management system and implemented a new risk assessment system to improve the efficiency of our inspections.



Ms Julia Leung, Deputy Chief Executive Officer and Executive Director of Intermediaries, speaks at an industry seminar

Off-site monitoring

We conduct off-site monitoring through regular interaction with licensed corporations to understand their business models and their plans to identify and assess risks. We assess the financial soundness of licensed corporations mainly through analysis of the regular financial returns they submit. We also utilise intelligence from a variety of sources and follow up on complaints and self-reported breaches. In addition, we examine applications by licensed corporations for subordinated loans and rule modifications or waivers. This helps us form a holistic view of the business profiles of licensed corporations.

Breaches noted during on-site inspections

	2017/18	2016/17	2015/16
Internal control weaknesses ^a	535	598	571
Breach of Code of Conduct ^b	320	441	388
Non-compliance with anti-money laundering guidelines	175	201	223
Failure to safekeep client money	59	62	45
Failure to safekeep client securities	38	58	41
Others	349	395	416
Total	1,476	1,755	1,684

^a Comprise 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, record keeping, client agreements, safeguarding of client assets and management responsibilities.

Note: Also see Table 4 in Breakdown of SFC activity data on pages 163-169 for more details.

Statistical information and financial position of the Hong Kong securities industry

	As at 31.12.2017	As at 31.12.2016	As at 31.12.2015
Securities dealers and securities margin financiers	1,222	1,104	1,002
Active clients	1,657,931	1,556,695	1,501,816
Total assets (\$ million)	1,337,404	1,078,521	1,089,976

	12 months to 31.12.2017	12 months to 31.12.2016	12 months to 31.12.2015
Total value of transactions ^a (\$ million)	73,901,390	63,495,134	84,787,467
Total operating profit (\$ million)	23,539	14,131	26,404

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

Note: 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. Figures reported by an overseas-incorporated licensed corporation that carries out its principal business activities outside Hong Kong and operates in Hong Kong as a branch office were excluded. Also see Table 8 in Breakdown of SFC activity data on pages 163-169 for more details.

Industry guidance and communication

We stay on top of market developments and explain our supervisory focus to the industry through circulars, frequently-asked questions (FAQs) and other communications. Where necessary, we also publish reports to highlight deficiencies and good practices observed during our thematic inspections. We also met with various industry associations during the year.

Securities brokers

To examine the accuracy of brokers' records of client assets and balances, we engaged an independent accounting firm to conduct a circularisation exercise for selected client accounts. We notified the industry of the exercise in a July 2017 circular and will share key findings from the exercise after it is completed.

We also conducted a review to assess the adequacy of internal controls over the supervision of account executives by large- and medium-sized brokers mainly serving retail investors. Where appropriate, we will share our observations and provide further guidance to the industry on areas of concern.

Securities margin financing

In light of the volatility in small-cap stocks and some licensed corporations' excessive exposure to securities collateral which was highly concentrated and illiquid, we issued a circular in October 2017 to firms providing securities margin financing to remind them to vigilantly monitor risks and adopt prudent margin lending and risk management policies. We also communicated our concerns to the broker community through industry seminars and conferences.

Liquidity risk management

In December 2017, we issued a circular to provide additional guidance on establishing and maintaining prudential risk management practices for client money, liquidity and the concentration risks of funding sources within group affiliates.

Best execution

Further to the best execution rules laid down in the Code of Conduct², we issued a circular with a thematic report in January 2018 to provide more guidance to the industry on our expected standards of firms' conduct and internal controls in delivering best

² Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

Intermediaries



Ms Leung explains the SFC's policy initiatives in a radio interview

execution. The report highlighted observations from a thematic review and provided examples of good industry practices as well as those which did not meet our expected standards.

Client facilitation

Although we highlighted common deficiencies associated with client facilitation in a 2014 supervisory briefing, we identified a number of inconsistent practices in recent routine inspections. In light of this, we issued a circular in February 2018 to provide more guidance to the industry on our expected standards for firms' conduct and internal controls in this area.

Sponsors

Following a thematic inspection of sponsors, we issued a circular in March 2018 to remind licensed corporations carrying out sponsor work of the expected standards of conduct and due diligence practices and to urge them to critically review and enhance their internal systems and controls. The deficiencies we identified from the inspection were discussed in an accompanying report.

Prime services and equity derivatives

In October 2017, we commenced a thematic review of prime services and related equity derivatives business conducted by major investment banks in Hong Kong to obtain an overview of the industry landscape, business practices, key risks and the investment banks' controls and identify potential issues for future policy and supervision initiatives. We will share our observations with the industry.

Futures brokers

Following the publication of our *Report on the fact-finding exercise on retail futures brokers* in April 2017, we issued a circular to futures brokers in June 2017 setting out key areas of regulatory concern, including the assessment criteria for established clients under the rules of the Hong Kong Futures Exchange Limited and setting-off arrangements between a client's different trading accounts, along with expected standards of conduct and internal controls.

Cryptocurrencies

We issued a statement and a circular on initial coin offerings (ICOs) in September 2017 to make the industry aware of the potential regulatory implications of fundraising using cryptocurrencies or digital tokens in view of their growing popularity. In a December 2017 circular on cryptocurrency-related products and derivatives, we reminded cryptocurrency operators of the legal and regulatory requirements in Hong Kong.

In February 2018, we urged investors to be cautious about the associated risks as we took regulatory action against a number of cryptocurrency exchanges and issuers of ICOs. Subsequently, in March 2018, an issuer halted its ICO to the Hong Kong public and agreed to unwind ICO transactions for Hong Kong investors.

Conflicts of interest

In a November 2017 joint circular with the HKMA, we reminded intermediaries about our expected standards for managing conflicts of interest arising from the sale of in-house products in the same financial group. The circular also provided examples of good practices observed during joint thematic reviews of selected conglomerate financial groups.

Alternative liquidity pools

From 2016 to 2017, we undertook a thematic review of the operations of selected licensed corporations' alternative liquidity pools (ALPs) to assess whether they complied with the requirements in the Code of Conduct and to gather market information. In April 2018, we published a circular together with a report summarising the findings and good practices identified in the thematic review and providing an overview of the ALP landscape in Hong Kong.

SFC Compliance Bulletin

We launched the *SFC Compliance Bulletin: Intermediaries* to provide guidance to intermediaries and other market practitioners on the SFC’s regulatory and supervisory priorities. The first issue, published in December 2017, highlighted the importance of managing conflicts of interest in selling practices and asset management and provided an overview of industry demographics.

Algorithmic trading

We held a forum in May 2017 for around 180 industry experts and representatives from licensed corporations to share their observations and good practices for algorithmic trading.

Anti-money laundering

We gave presentations to about 1,800 management and compliance practitioners on anti-money laundering and counter-terrorist financing at three SFC seminars and six others organised by industry associations.

Licensing Handbook

To provide easier access to licensing information, we published a new *Licensing Handbook* in April 2017 which consolidates information contained in various publications and FAQs. We also revamped the licensing section of the SFC website. Hyperlinks were included in the handbook and webpages for convenient cross-referencing of statutory provisions.

A framework for Fintech

Financial technology (Fintech) continues to evolve rapidly with the active participation of both start-ups and incumbent financial institutions. We closely monitor these developments with a focus on how they intersect with our rules and regulations. Through various forms of engagement, we keep track of the emergence of new business models which have implications for our regulatory work.

We are open to discussions with firms utilising innovative technologies who demonstrate a serious commitment to carry out regulated activities which may enhance investment choice and quality as well as benefit investors and the Hong Kong markets at large. Accordingly, we launched the SFC Regulatory Sandbox in September 2017 to provide a confined regulatory environment for qualified firms to operate regulated activities under the SFO before their technologies are applied on a full scale.

In September 2017, we issued a circular to clarify the “relevant industry experience” requirement for ROs of Fintech companies looking to be licensed.

We consider all relevant factors in assessing an RO application, including the firm’s principal business model, governance structure and the competence of its key personnel. For instance, where the regulated activity carried out by a licensed corporation is based on the utilisation of a highly innovative technology, an RO applicant’s direct experience with the technology may be essential for integrating the technology into the regulated activity.

In October 2017, we co-organised a full-day programme with the HKMA to discuss Fintech-related regulatory issues. The event was part of Hong Kong Fintech Week sponsored by InvestHK.

During the year, we worked with the Investor Education Centre to publish educational materials and also participated in public educational campaigns on risks associated with ICOs and cryptocurrencies.

To foster cross-border collaboration, we entered into Fintech cooperation agreements with the UK, Australia, Malaysia, Dubai and Switzerland.

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Investor compensation

We completed a study of ways to enhance Hong Kong's investor compensation regime and in April 2018 launched a public consultation on proposed enhancements for better investor protection.

The Investor Compensation Company Limited, a wholly-owned SFC subsidiary, received one claim against the Investor Compensation Fund and processed six claims during the year.

Investor compensation claims

	2017/18	2016/17	2015/16
Received	1	10	39
Processed	6	19	450
– Compensation payments made	3	14	413
– Rejected	3	4	19
– Withdrawn	0	1	4
– Reconsidered	0	0	14



Net asset value of compensation funds

	As at 31.3.2018 (\$ million)	Change	As at 31.3.2017 (\$ million)	Change	As at 31.3.2016 (\$ million)
Unified Exchange Compensation Fund ^a	75.8	4%	72.9	2.1%	71.4
Investor Compensation Fund ^b	2,361.2	3.5%	2,280.4	3.1%	2,210.9
Total	2,437	3.5%	2,353.3	3.1%	2,282.3

^a See pages 149-162 for the financial statements of the Unified Exchange Compensation Fund (UECF). The Investor Compensation Fund (ICF) was established by the 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.

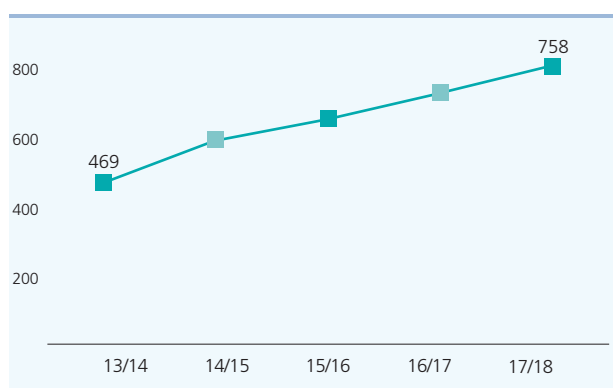
^b See pages 130-148 for the financial statements of the ICF.

Investment products

We authorise and regulate investment products offered to the public and monitor their ongoing compliance with regulatory requirements.

Our vision is to formulate policies which facilitate market growth and product innovation while supporting the development of Hong Kong as a leading asset management centre and preferred place of fund domicile.

Hong Kong-domiciled SFC-authorized funds



Facilitating market development Authorisations

As of 31 March 2018, a total of 2,799 SFC-authorized collective investment schemes (CIS) were on offer to the public. During the year, we authorised 134 CIS, comprising 120 unit trusts and mutual funds, one investment-linked assurance scheme (ILAS) and 13 mandatory provident fund (MPF) pooled investment funds.

We also authorised 114 unlisted structured investment products for public offering.

Authorised CIS

	As at 31.3.2018	As at 31.3.2017	As at 31.3.2016
Unit trusts and mutual funds	2,215	2,203	2,133
ILAS	299	300	301
Pooled retirement funds	34	34	34
MPF schemes	31	35	37
MPF pooled investment funds	194	182	173
Others	26 ^a	26	26
Total	2,799	2,780	2,704

^a Comprising 15 paper gold schemes and 11 real estate investment trusts (REIT).

Unlisted structured investment products

	2017/18	2016/17	2015/16
Unlisted structured investment products ^a	114	100	94
Authorisations granted under section 105 of the SFO ^b	84	84	85

^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 Offering documents and advertisements of unlisted structured investment products offered to the Hong Kong public.

ETFs and leveraged and inverse products

The total number of SFC-authorized exchange-traded funds (ETF) listed on The Stock Exchange of Hong Kong Limited stood at 134 (including 27 leveraged and inverse (L&I) products) as of 31 March 2018. In January 2018, we published a research paper on the Hong Kong ETF market and related topical issues in light of recent local and international developments. This paper is intended to provide context for future policy discussions.

Investment products

Renminbi products

We facilitate the development of renminbi products for offering to the public in Hong Kong. The total number of SFC-authorized unlisted funds and ETFs investing onshore in the Mainland securities markets¹ stood at 57 and 32 respectively as of 31 March 2018.

Mutual recognition of funds

France

In July 2017, we signed a Memorandum of Understanding (MoU) on mutual recognition of funds (MRF) with Autorité des Marchés Financiers. The MoU allows eligible French and Hong Kong public funds to be distributed in the other market through a streamlined vetting process. This opens up the opportunity for Hong Kong funds to be sold directly to retail investors in a leading European Union market.

To facilitate the implementation of this arrangement, we held an industry briefing in July 2017. We also issued a circular, frequently asked questions and an

information checklist to provide guidance on specific requirements and application procedures.

Switzerland

As of 31 March 2018, four SFC-authorized funds were approved by the Swiss Financial Market Supervisory Authority for distribution to retail investors in Switzerland under the Switzerland-Hong Kong MRF arrangement.

Mainland China

We granted authorisation for 50 Mainland funds under the Mainland-Hong Kong MRF scheme while the China Securities Regulatory Commission (CSRC) authorised 11 Hong Kong funds as of 31 March 2018.

ETF Connect

We work closely with the CSRC as well as stock exchanges and clearing houses in the Mainland and Hong Kong to study technical issues and proposals for implementing ETF Connect.

SFC-authorized renminbi investment products

	As at 31.3.2018
Unlisted products	
Unlisted funds investing onshore through RQFII, Stock Connect, Bond Connect and CIBM	57
Unlisted funds investing primarily in offshore dim sum bonds, fixed income securities and money market instruments	18
Paper gold schemes with renminbi features	1
Recognised Mainland funds under Mainland-Hong Kong Mutual Recognition of Funds	50
Unlisted structured investment products with renminbi features ^a	100
Listed products	
ETFs investing onshore through RQFII, Stock Connect, Bond Connect and CIBM	32
Renminbi gold ETFs ^b	1
Renminbi REITs	1

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

^b Only includes gold ETF denominated in renminbi.

¹ These unlisted funds and ETFs are renminbi-denominated funds which primarily invest in Mainland securities markets through the Renminbi Qualified Foreign Institutional Investor (RQFII) quota, Stock Connect, Bond Connect and the China Interbank Bond Market (CIBM).

Revamped post-authorisation process

On 1 February 2018, we formally adopted the revamped process for applications for approval of post-authorisation changes (including scheme changes, termination, merger and withdrawal of authorisation) and authorisation of revised offering documents for SFC-authorized funds². The revamped process increases procedural transparency, enables timely notification of post-authorisation changes to investors and makes more efficient use of our resources.

Open-ended fund companies

In June 2017, we launched a public consultation on the Securities and Futures (Open-ended Fund Companies) Rules and the Code on Open-ended Fund Companies, which set out the detailed legal and regulatory requirements applicable to the new open-ended fund companies (OFC) structure. The OFC regime will broaden the choice of investment fund vehicles. Consultation conclusions were published in May 2018 and the regime will take effect following the completion of the legislative process.

New system for investment product information management

In 2017, we put in place a new Investment Product Management system to facilitate our product authorisation work, which involves processing large volumes of data and information. The system captures all case-related information for both product applications and post-authorisation matters, while simplifying and standardising processes and workflows.

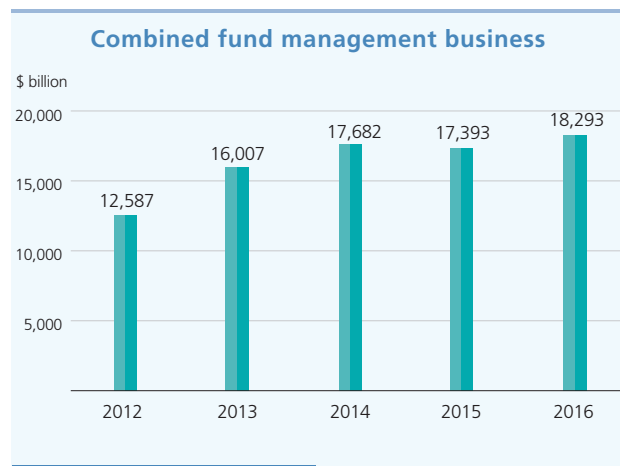
This helps us closely monitor performance pledges^a and data accuracy, greatly enhancing operational efficiency. Moreover, the new system is more fully integrated with our other systems, including the SFC Online Portal^b, allowing us to collect timely data from the industry for regulatory purposes and monitor market risks more effectively.

^a See performance pledges on page 30 for details.
^b The SFC Online Portal enables market participants to file documents, make submissions and pay fees to the SFC electronically.

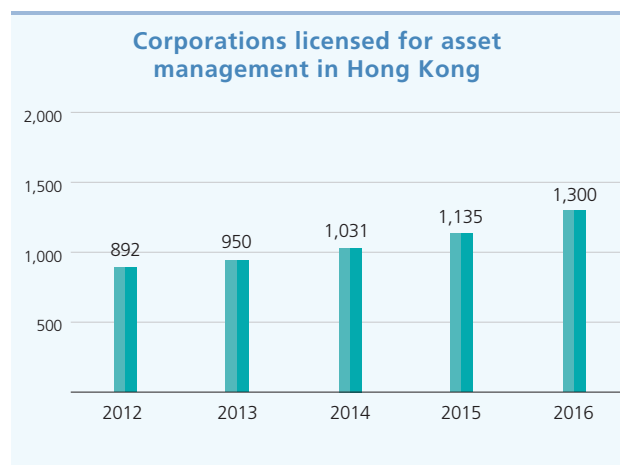
Fund management activities

We published the 18th annual Fund Management Activities Survey in July 2017. Hong Kong’s combined fund management business increased by 5.2% year-on-year to \$18,293 billion as of 31 December 2016, while private wealth management business grew by 9% to \$5,203 billion.

The number of corporations licensed for asset management in Hong Kong also increased by 14.5% in 2016, while the number of staff who engaged in activities other than sales and marketing increased by 3.7% year-on-year to 11,115 in 2016.



Source: Fund Management Activities Survey



² Excluding mandatory provident funds authorised only under the SFC Code on MPF Products.

Investment products



Ms Christina Choi, Executive Director, Investment Products speaks at the MPFA's Workshop on Governance of MPF Trustees

Enhanced regulation

Asset management

Following a public consultation concluded in November 2017, enhancements to asset management regulation proposed in light of international developments will come into effect in November 2018. In addition, enhancements to point-of-sale transparency to better address conflicts of interest in selling investment products, including by governing the use of the term "independent" by intermediaries, will become effective in August 2018. We also launched a further consultation on disclosure requirements applicable to discretionary accounts.

Online distribution and advisory platforms

In May 2017, we launched a three-month public consultation on proposed guidelines for online distribution and advisory platforms which provide tailored guidance to the industry on the design and operation of online platforms and clarify how the suitability requirement would operate in the online environment. We published consultation conclusions and launched a further consultation on proposed requirements applicable to offline sale of complex products in March 2018. The guidelines will become effective in April 2019.

Code on Unit Trusts and Mutual Funds

To update the regulatory regime for SFC-authorized funds, we launched a three-month public consultation in December 2017 on proposed amendments to the Code on Unit Trusts and Mutual Funds³ which seek to ensure that the regulations governing public funds remain robust and aligned with international standards and market developments. Key proposals include strengthening requirements for key operators, providing greater flexibility and enhanced safeguards for funds' investment activities and introducing new fund types, including active ETFs.

Surveillance and monitoring

As part of our ongoing surveillance and monitoring work, we closely monitor the liquidity of SFC-authorized funds through reports from their managers on any unusual or untoward activities, including significant redemptions, suspensions of dealing and liquidity problems. We regularly review abnormal fluctuations of the daily unit prices of Hong Kong-domiciled public funds as compared with their respective peer groups. We also monitor ETFs and L&I products through analysing data related to pricing, exposure to counterparties and, in the case of L&I products, daily rebalancing activities.

We regularly conduct surveillance of the marketing materials of SFC-authorized funds and fund managers' websites to ascertain whether they comply with regulatory requirements.

We also conduct routine surveillance of advertisements and handle complaints about property-related or other suspected arrangements which may be CIS. We raised around 40 enquiries about suspicious CIS during the year.

³ Consequential amendments were also proposed to the SFC Code on MPF Products, the Code on Pooled Retirement Funds and the Code on Investment-Linked Assurance Schemes.

Listings and takeovers

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 promote the development of a fair and orderly securities market in Hong Kong.

Listing policy

On 15 September 2017, the SFC and SEHK issued conclusions to their joint consultation on proposed enhancements to SEHK's decision-making and governance structure for listing regulation. The conclusions paper clarifies the role of the SFC as the statutory regulator which administers the Securities and Futures Ordinance (SFO) and the Securities and Futures (Stock Market Listing) Rules (SMLR), and

which supervises, monitors and regulates the activities carried on by SEHK. It also clarifies SEHK's role as the regulator administering the Listing Rules¹.

In March 2018, the SFC and SEHK signed an addendum to the Memorandum of Understanding Governing Listing Matters², following which a new Listing Policy Panel³ was established as an advisory, consultative and steering body to initiate and centralise discussions on listing policy with broader regulatory or market implications.

Given the high level of interest in infrastructure investment opportunities in developing markets, such as those related to the Mainland's "Belt and Road" initiative, we issued a statement in April 2017 setting out the factors we take into account when reviewing the listing applications of infrastructure project companies.

Explaining SMLR

Under our new, front-loaded regulatory approach, we engage in targeted intervention at an early stage to suppress illegal, dishonourable and improper market practices and protect the integrity of financial markets and the interests of investors. This new approach has increased our direct presence in more crucial listing matters which fall within the scope of the SMLR^a or the SFO.

Section 6(2) of the SMLR empowers us to raise objections to a listing of shares (including by listed companies). If it is likely that an objection would be raised, we will promptly issue a "letter of mindedness to object" (LOM)^b to the applicant setting out our substantive concerns, which we then discuss with the applicant and its advisers.

This is a departure from the SFC's previous approach where comments on initial public offering (IPO) applications were raised via SEHK. It is more efficient for an applicant to communicate directly with the SFC regarding our concerns.

^a SMLR is subsidiary legislation of the SFO.

^b An LOM sets out the substantive concerns of the SFC along with detailed reasons.

^c This decision is subject to review by the Securities and Futures Appeals Tribunal.

If the applicant's response to an LOM fails to address our concerns, we will issue a final decision notice to raise objections^c. Cases handled so far involve doubtful financial projections and false or misleading information related to suppliers. In one case, a listed company failed to address our concerns about a share placement to be conducted at a substantial discount to a small group of subscribers and had to cancel the placement.

Section 8 of the SMLR empowers the SFC to direct the suspension of trading in a listed company's shares. Unless urgent action is required by circumstances such as protecting investors, the SFC would normally first issue a "show cause letter" setting out its concerns and give the company an opportunity to respond.

In July 2017, we published the first issue of the *SFC Regulatory Bulletin: Listed Corporations*, providing guidance on our new regulatory approach.

¹ SEHK will be the primary front-line regulator and will remain the contact point for all listing applications save in respect of concerns raised by the SFC under the SMLR.

² The Memorandum of Understanding Governing Listing Matters was signed in January 2003.

³ The Listing Policy Panel consists of 12 members comprising senior representatives of the SFC, the Listing Committee, Hong Kong Exchanges and Clearing Limited (HKEX) and the Takeovers and Mergers Panel. It is not a committee under the SFC, HKEX or SEHK.

Listings and takeovers

We issued a guidance note in May 2017 on directors' duties regarding valuations in corporate transactions together with a statement on the liability of valuers for the disclosure of false or misleading information.

Jointly, the SFC and SEHK are conducting a holistic review of listing regulation which seeks to address issues relating to GEM⁴, capital raisings and the delisting framework under the Listing Rules.

SEHK issued a consultation paper on proposed changes to the regulation of GEM on 16 June 2017 and published consultation conclusions on 15 December 2017. The ensuing changes, which took effect on 15 February 2018, include:

- removing the streamlined process for GEM transfers to the Main Board;
- introducing a mandatory public offering requirement of at least 10% of the total offer size for all GEM initial public offerings (IPOs);
- increasing the minimum cash flow requirement for GEM applicants from \$20 million to \$30 million; and
- increasing the minimum market capitalisation of Main Board applicants at the time of listing from \$200 million to \$500 million.

In September 2017, SEHK launched a consultation which sought to address concerns about abusive fundraisings by some listed companies as well as a separate consultation on proposals to streamline the delisting procedures for suspended stocks.



Mr Brian Ho, Executive Director, Corporate Finance speaking at the Conference on Business Ethics for Listed Companies 2017

In response to market feedback to SEHK's June 2017 New Board Concept Paper, SEHK announced a proposal in December 2017 to expand the existing listing regime by allowing the listing on the Main Board of companies from emerging and innovative sectors. In February 2018, SEHK issued a consultation paper on proposals and draft rules to introduce a new listing regime for companies with weighted voting rights structures, biotechnology companies not meeting the financial eligibility tests under the current listing rules and overseas-listed companies seeking a secondary listing in Hong Kong. The new listing regime was implemented on 30 April 2018.

As of 3 July 2017, disclosure of interests notices must be submitted via Hong Kong Exchanges and Clearing Limited's new electronic filing system⁵. A three-month transition period was provided.

⁴ Formerly known as the Growth Enterprise Market.

⁵ The Disclosure of Interests Online System. This requirement follows the commencement of mandatory electronic filing provisions under Part XV of the SFO.

New listing applications

	2017/18	2016/17	2015/16
Total listing applications ^a	309	245	218
Cases lapsed/withdrawn/rejected during the year	27	38	26
Cases returned	3	5	3
New listings ^b	203	148	131

^a Including applications for transfer from GEM to the Main Board (2017/18: 22; 2016/17: 18; 2015/16: 12).

^b Including successful transfers from GEM to the Main Board (2017/18: 17; 2016/17: 6; 2015/16: 12).

IPO applications

We vet listing applications and raise enquiries on the basis of insufficient or inadequate disclosures, and object to a listing if it appears to us that it would not be in the interest of the investing public or in the public interest for the securities to be listed.

We received 309 listing applications via SEHK during the year, up 26% from 245 last year. We shared with SEHK our comments or concerns on 299 of them. Three listing applications were returned by SEHK, and an eight-week moratorium⁶ was imposed because the application proofs or related documents were not substantially complete.

To tackle serious disclosure and public interest issues, we issued seven LOMs to listing applicants directly during the year (see sidebar on page 51). Subsequently, we issued final decision notices to object to two of these applicants because their responses failed to address our concerns⁷. Of the other five, two were withdrawn, two lapsed⁸ and one was still being vetted at the end of the reporting period.

Corporate conduct

We monitor company announcements on a daily basis to identify corporate misconduct and irregularities in disclosures, including failure to disclose information in a timely manner and false or misleading disclosures. We also focus on transactions and corporate actions which are potentially detrimental to shareholders, paying particular attention to serious misbehaviour.

We use our information gathering power under section 179⁹ to raise enquiries with listed companies and, where our concerns are not addressed satisfactorily, intervene directly.

Takeovers matters

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, which aim to afford equal treatment of shareholders, to mandate disclosure of timely and adequate information to enable shareholders to make informed decisions as well as to ensure a fair and informed market.

⁶ The respective applicants can only submit a new listing application with a new application proof more than eight weeks after the return.

⁷ After our objection, one of these applicants resubmitted a listing application and was subsequently listed after addressing our concerns.

⁸ After a lapse, one applicant resubmitted a listing application and was subsequently listed after addressing our concerns.

⁹ 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.

Listings and takeovers

Takeovers and Mergers Panel rulings

The Takeovers and Mergers Panel met in April 2017 to consider the application by Television Broadcasts Limited (TVB) for a whitewash waiver in relation to a share buy-back offer it announced in January 2017. The panel ruled that full disclosure should be made of the shareholding and ownership structure of Young Lion Holdings Limited¹⁰. It also ruled on how the shareholders' resolution to approve the whitewash waiver should be voted¹¹.

In May 2017, TVB applied to the High Court of Hong Kong to commence a judicial review of the panel's April decision on how shareholder votes should be counted, which the High Court quashed following a September 2017 hearing. Other aspects of the panel's ruling, including full disclosure of Young Lion's shareholding and ownership structure, were not part of the judicial review and remain valid.

ICE

This year, the SFC cross-divisional unit designated ICE (Intermediaries, Corporates, Enforcement)^a recorded significant progress in tackling problems affecting the quality of our markets.

One major issue was the unusual price volatility in GEM stocks. The average first day price gain for GEM stocks which listed by way of placing was 743% in 2015 and 530% in 2016. Mobilising ICE, we issued two statements in January 2017 to remind listed companies and sponsors of their obligations to ensure compliance with the GEM Listing Rules, including that conditions exist for an open, orderly and informed market at the time of listing.

When we also exercised our powers under SMLR to object to GEM placings with a high concentration of shareholders, this had an immediate impact. Some companies delayed sub-standard listing plans and others changed their offerings to include a public offer tranche. In the year following the January statements, the average first-day price gain for GEM stocks was only 23%, and shareholding concentrations in newly-listed GEM companies were also lower.

Another longstanding problem was the use of unrealistic valuations to support suspicious asset disposals or acquisitions by listed companies. In May 2017, ICE coordinated the issuance of a

guidance note on directors' duties, a circular to financial advisers and a statement on the liability of valuers to remind them of their responsibility to uphold shareholders' interests when corporate assets are acquired or disposed.

In June 2017, ICE authorised one of the largest search operations in our history, pulling together over 100 staff to search multiple premises of interrelated companies. These companies comprised one of several groups working in coordination to extract value from unsuspecting investors by conducting apparently legitimate transactions which may not make any business sense beyond a very superficial level. The investigations were based on suspicions that market manipulation and financing transactions designed to defraud minority shareholders could be involved.

In March 2018, ICE issued a circular that identified continued deficiencies in sponsor work and urged licensed corporations to critically review and enhance their systems and controls to comply with the expected standards and the relevant codes, rules and regulations when carrying out sponsor work.

ICE allows us to deploy the full spectrum of our regulatory tools through tighter cross-divisional collaboration, whilst keeping a close watch on market developments to identify emerging problems and formulate strategies to address them proactively at an early stage.

^a The unit, which pools resources from the Intermediaries, Corporate Finance and Enforcement divisions, was established in 2016 in response to the increasing prevalence of regulatory issues relating to corporate behaviour and conduct.

¹⁰ Young Lion together with its concert parties holds 29.9% of TVB's shares and could hold up to 41.2% following the buy-back.

¹¹ The panel also ruled that TVB's whitewash waiver should be granted subject to a majority of votes cast in favour of a shareholders' resolution to approve the offer (without adjustment), and the whitewash waiver should not be put before TVB's shareholders for a separate vote.

Takeovers activities

Investigations and enquiries remained an important focus of our supervision and regulation of takeovers activities. We sanctioned a number of parties for breaching the Takeovers Code during the year:

- In August 2017, we publicly censured and imposed a 24-month cold shoulder order against Yeung Wing Yee for failing to making a general offer after acquiring over 30% of the shares in Union Asia Enterprise Holdings Limited, depriving the company's shareholders of the right to receive an offer.
- In the same month, we also publicly censured China Life Insurance (Overseas) Company Limited for breaching the dealing disclosure requirements during the privatisation of Glorious Property Holdings Limited.
- In September 2017, we publicly censured Chen Chi-Te and Kenneth C.M. Lo (both directors of Taiwan Cement Corporation) for breaching the dealing provisions during the company's proposed privatisation of TCC International Holdings Limited.
- In December 2017, Zhang Qiang was publicly censured for acquiring shares in Feishang Non-metal Materials Technology Limited within six months after the close of an offer at above the offer price.

Takeovers activities

	2017/18	2016/17	2015/16
General and partial offers under Code on Takeovers and Mergers	59	73	50
Privatisations	11	13	7
Whitewash waiver applications	41	37	51
Other applications under Code on Takeovers and Mergers [^]	289	365	323
Off-market and general offer share buy-backs	1	4	1
Other applications under Code on Share Buy-backs [^]	0	2	3
Total	401	494	435

[^] 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 pages 163-169 for more details.

- In March 2018, Nomura International (Hong Kong) Limited and Lee Yuen Yee, Annisa were publicly criticised for failure to comply with requirements for research reports and profit forecasts during a possible offer for West China Cement Limited.

Code amendments

We launched a three-month consultation on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs in January 2018. Key proposals enhance investor protection by increasing the voting approval threshold for whitewash waivers to 75% of independent shareholders and empowering the Takeovers and Mergers Panel to require compensation to be paid to shareholders who have suffered as a result of a breach of the codes.

Other proposed amendments clarify the obligations of persons dealing with the Takeovers Executive¹², the Takeovers and Mergers Panel and the Takeovers Appeal Committee in all codes-related transactions, including their prompt cooperation and assistance and the provision of true, accurate and complete information.

We made changes to the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs to introduce a new section 19.1 in July 2017 to align them with the newly effective Financial Institutions (Resolution) Ordinance as well as a new note to section 4.2 in April 2018 to bring them in line with the new listing regime for companies from emerging and innovative sectors.

¹² Refers to the Executive Director of the SFC's Corporate Finance Division or his delegate.

Market infrastructure and trading

To ensure orderly markets, we supervise and monitor exchanges and clearing houses in Hong Kong. During the year, we made progress on a number of initiatives to enhance the securities and futures markets.

Supervision of HKEX

On-site inspection

We conduct regular on-site inspections of the non-listing-related operations of Hong Kong Exchanges and Clearing Limited (HKEX). In August 2017, we conducted an inspection of its cash market clearing and settlement operations, focusing on the admission and monitoring of clearing participants as well as depository, custodian and nominee services.

Recognised clearing houses

During the year, we worked on risk management initiatives to improve the resilience of recognised clearing houses in Hong Kong and better comply with international standards published by the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions. We worked with HKEX to enhance the clearing houses' recovery plans for managing extreme market situations and also approved measures to strengthen clearing guarantee funds, including risk-based contributions from the clearing houses and more timely collection of collateral from clearing members. In addition, we began to develop resolution plans for the clearing houses under the Financial Institutions (Resolution) Ordinance which came into effect on 7 July 2017.

Closing Auction Session

In July 2017, we approved HKEX's launch of Closing Auction Session (CAS) Phase 2¹ which expanded the list of securities to constituents of the Hang Seng Composite SmallCap Index and allowed regulated short-selling orders to be placed during CAS.

New products

We approved a number of derivative products proposed by HKEX to meet the trading and hedging needs of market participants (see table below).

Hong Kong as a risk management centre

As mainland China continues to open up and integrate with global capital markets, it is vital to enhance Hong Kong's role as the premier risk management centre for Mainland risk and a booking hub for Asian derivatives.

A-share futures

To enable Hong Kong to develop A-share index futures in due course, we entered into a memorandum of understanding (MoU) with the China Securities Regulatory Commission (CSRC) on 28 December 2017 which facilitates supervisory and enforcement cooperation in the Mainland and Hong Kong futures markets and enhances supervisory assistance and information exchange on cross-boundary derivatives, futures exchanges and futures brokers.

Derivative products approved

	Trading commencement date
Physically-settled gold futures contracts	10 July 2017
Cash-settled iron ore futures contract	13 November 2017

¹ CAS Phase 1 was launched in July 2016 to facilitate trade execution of major index constituents and all exchange-traded funds at closing prices.

OTC derivatives

In line with the Group of Twenty's commitment to reform the over-the-counter (OTC) derivatives market, we have been working with the Hong Kong Monetary Authority (HKMA) to implement an OTC derivatives regulatory regime in Hong Kong in phases².

Phase 2 mandatory reporting of OTC derivatives transactions, covering all five major asset classes³, came into effect on 1 July 2017.

In response to market requests, we launched a joint HKMA-SFC consultation in April 2017 and implemented subsidiary legislation to adjust the scope of the term "OTC derivative product" under the Securities and Futures Ordinance (SFO). Engaging with market participants, we identified issues relating to the scope of regulated activities, on which we consulted the market in December 2017⁴, and are proposing refinements to address them.

In March 2018, we issued another joint HKMA-SFC consultation on enhancements to the OTC derivatives regulatory regime to mandate the use of Legal Entity Identifiers⁵ for the reporting obligation, expand the clearing obligation and adopt a trading determination process for introducing a platform trading obligation.

OTC Clear

For mandatory clearing purposes, we designated OTC Clearing Hong Kong Limited (OTC Clear) as a central counterparty for Hong Kong dollar basis swaps in June 2017. We also approved OTC Clear's new products, including non-deliverable interest rate swaps in Asian currencies, cross-currency swaps for Hong Kong dollar vs US dollar and deliverable FX forwards and swaps.

Mutual market access

Stock Connect

We are in discussions with the Mainland authorities to further expand the scope of eligible securities under Stock Connect, which allows Hong Kong and Mainland investors to trade eligible stocks in each other's markets.



Mr Keith Lui, Executive Director of Supervision of Markets, at the WFC Global Conference of Central Securities Depositories 2017

Stock Connect now covers some 1,500 Mainland stocks and 460 Hong Kong stocks, representing more than 80% of the two markets' combined market capitalisation.

As of 31 March 2018, southbound trading from Shanghai and Shenzhen into Hong Kong reached a net inflow of RMB723.8 billion since the programme's launch. Through northbound trading, international investors bought in RMB389.7 billion worth of A-shares as of that date.

The daily quotas were increased to RMB52 billion for each of the northbound trading links and RMB42 billion for each of the southbound trading links effective 1 May 2018.

Since inception, Stock Connect accounted for an increasing share of Hong Kong's market turnover. On average, daily southbound trading reached 7% of total trading in Hong Kong from January to March 2018, compared to 6% in 2017 and 3% in 2016. Northbound trading also increased to 2% of the Mainland's total market turnover, compared to 1% in 2017 and 0.3% in 2016.

² We implemented two phases of mandatory reporting—Phase 1 reporting came into effect on 10 July 2015 and Phase 2 on 1 July 2017. The first phase of mandatory clearing became effective on 1 September 2016.

³ Including interest rates, foreign exchange, credit, commodities and equities.

⁴ See Intermediaries on pages 39-46.

⁵ A unique 20-digit, alpha-numeric code which identifies entities in a financial transaction.

Market infrastructure and trading

Bond Connect

On 29 June 2017, we approved the automated trading services (ATS) application of Bond Connect Company Limited, a Hong Kong-based joint venture established by HKEX and the China Foreign Exchange Trade System & National Interbank Funding Center, to facilitate the operation of Bond Connect. Northbound trading under the scheme, launched on 3 July 2017, allows Hong Kong and overseas investors to invest in the China Interbank Bond Market. We are collaborating with other regulatory authorities to closely monitor the scheme's operations.

Market enhancements

Investor identification

We worked with HKEX and the Mainland exchanges and clearing house to develop an investor identification model for northbound trading under Stock Connect to facilitate market surveillance. To this end, we reached an agreement with the CSRC in November 2017 and announced the expected launch of the model in the third quarter of 2018⁶. We also agreed to develop a similar model for southbound trading after the northbound trading model is implemented.

Position limit regime

Following the conclusion of a public consultation in March 2017, the enhanced position limit regime for the futures market took effect on 1 June 2017. The regime expanded the scope of excess position limits which can be granted to qualified market participants. Amendments were made to the Securities and Futures (Contracts Limits and Reportable Positions) Rules as

well as the SFC's Guidance Note on Position Limits and Large Open Position Reporting Requirements. Since implementation, we have received more enquiries about and applications for excess position limits.

Automated trading services

Under the SFO, two regimes regulate ATS providers. Part III of the SFO authorises those offering facilities similar to those of a traditional exchange or clearing house and Part V licenses intermediaries providing dealing services with ATS as an added facility. During the year, trades conducted on authorised trading venues were mainly in commodity futures, benchmark index futures and options, bonds, equities and exchange-traded funds.

Over the past year, we approved 12 applications from overseas regulated exchanges and electronic trading facilities. The average daily trading volume of futures contracts originating from Hong Kong to authorised overseas exchanges was about 326,000 contracts for the 12 months ended 31 March 2018.

Short position reporting

In November 2017, we published a Short Position Reporting Service User Guide and frequently asked questions on our website. This followed the March 2017 expansion of short position reporting requirements to all securities which are permitted for short-selling under the rules of The Stock Exchange of Hong Kong Limited.

During the year, aggregated short positions for these securities accounted for 1.3% to 1.6% of the total market capitalisation of these securities.

ATS providers

	As at 31.3.2018	As at 31.3.2017	As at 31.3.2016
Under Part III	57	49	38
Under Part V	24	24	24

⁶ On 30 November 2017, HKEX issued an information paper, *Investor ID Model for Northbound Trading Under Stock Connect*, which sets out operational details of the regime.

Enforcement

Combating crime and misconduct in the securities and futures markets is crucial to maintain Hong Kong's status as an international financial centre. To send strong deterrent messages, protect investors and ensure fair and efficient markets, we focus on high-impact cases which pose the greatest risks to the investing public.

Our tools under the SFO

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, fines¹ and suspensions or revocations of licences, and apply to the court for injunctive and remedial orders against wrongdoers in favour of victims.

Our work in figures

280
cases initiated

254
investigations completed

31
disciplinary
actions

8,461
requests for trading and account records[^]

54
criminal charges laid

22
cases with search
warrants executed

[^] These requests were made to intermediaries as a result of our surveillance of untoward price movements and turnover.
Note: Data as of 31 March 2018.

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

Enforcement

To effectively communicate our enforcement priorities and new approach to the industry and stakeholders, we issued two issues of the *Enforcement Reporter* and spoke at public and private events and interviews.

We allocated resources to harder, more serious cases, reducing our overall caseload by setting aside or not taking up low-priority cases.

During the year, we commenced 280 investigations and laid 54 criminal charges against 11 individuals and three corporations and secured convictions against nine persons and five corporations.

We obtained disqualification and restorative orders against 28 persons and two corporations. Civil actions seeking financial redress and other remedial orders against 97 persons and corporations in 22 cases are pending before the court.

Disciplinary action was taken against 16 persons and 15 corporations. In addition, we commenced two cases before the MMT against two corporations and 11 persons for alleged late disclosure of inside information.

We also issued 277 compliance advice letters to address areas of regulatory concern and raise standards of conduct and compliance in the industry.

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.

During the year, we initiated an organisation-wide market surveillance intelligence project to collect and analyse data to identify market conduct risks².

Our surveillance of untoward price and turnover movements resulted in 8,461 requests for trading and account records from intermediaries. We also received and assessed 172 notifications from intermediaries³ regarding suspicious equity and derivative trading. The number of market surveillance cases rose 16% year-on-year.

30
disqualification and
restorative orders

\$483 million
in fines

97
individuals and corporations subject to
ongoing civil proceedings

23
high shareholding
concentration announcements

277
compliance advice
letters issued

² See Risk assessment on page 68.

³ Intermediaries are required to report clients' suspected market misconduct to the SFC under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

We posted 23 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.

Enforcement actions

Corporate fraud and misbehaviour

Corporate conduct remains our top enforcement priority, especially when it relates to listed companies. Under our new approach, we engage in targeted intervention at an early stage to suppress illegal and improper market practices. We also increased our direct presence in more crucial listing matters which fall within the scope of the Securities and Futures (Stock Market Listing) Rules (SMLR) or the SFO⁴.

During the year, we suspended trading in the shares of 12 listed companies under section 8 of the SMLR for suspected misleading financial statements and corporate fraud and to protect investors from harm. We investigated 21 sponsor firms, and issued 13 notices of proposed disciplinary actions against eight firms and four sponsor principals. We are considering similar disciplinary notices and other enforcement actions against other firms and sponsor principals.

We conducted joint search operations with the Independent Commission Against Corruption in appropriate cases, efficiently using the enforcement powers and investigative tools of the two authorities to gather evidence of financial crimes.

We commenced legal proceedings under section 214 of the SFO in one case in the Court of First Instance (CFI) where we are seeking disqualification orders against Far East Holdings International Limited's former managing director and chief executive officer, Duncan Chiu, a former non-executive director and a former company secretary and financial controller for alleged misconduct towards the company and its shareholders.

We also commenced proceedings in the MMT alleging that Fujikon Industrial Holdings Limited failed to disclose inside information as soon as reasonably practicable and executive directors Yeung Chi Hung and Chow Lai Fung were reckless or negligent in causing the alleged breach.

Other notable cases during the year included:

- The MMT, in its heaviest financial sanction to date, ordered the former chairman and chief executive officer of Greencool Technology Holdings Limited, Gu Chujun, to disgorge approximately \$481 million of profit from grossly overstating financial statements over a five-year period. The MMT also made a cold shoulder order⁵ against Gu for five years as well as a cease and desist order to prohibit him from engaging in future market misconduct. He and four other former senior executives were also disqualified from serving as a director or being involved in the management of any listed company in Hong Kong for three to five years.
- The MMT ruled that Mayer Holdings Limited and nine of its former directors and senior executives failed to disclose inside information as soon as reasonably practicable and fined them a total of \$10.2 million. The MMT also imposed disqualification orders against the senior executives for periods ranging from 12 to 20 months and ordered the company to appoint an independent professional adviser to review its procedures for compliance with the corporate disclosure regime. The company and eight of the senior executives have filed appeals.
- The CFI disqualified the former chairman of Hanergy Thin Film Power Group Limited, Li Hejun, and four former independent non-executive directors of Hanergy from being a director for three to eight years for serious breaches of director's duties. It also ordered Li to procure the payment of outstanding receivables due to Hanergy from its parent company and affiliates.
- For materially overstating its turnover and understating its bank borrowings in its initial public offering (IPO) prospectus or subsequent results announcements, the CFI ordered Qunxing Paper Holdings Company Limited, its former chairman and vice-chairman Zhu Yu Guo and his son, Zhu Mo Qun, as well as a subsidiary, to compensate investors who subscribed for shares in its IPO or purchased them in the secondary market between 2007 and 2011. The CFI also ordered that payments be made to a corporate investor, which subscribed for its unlisted warrants in 2011.

⁴ See Listings and takeovers on pages 51-55.

⁵ An order which prohibits a person from dealing directly or indirectly in Hong Kong's financial markets.

Enforcement



Mr Thomas Atkinson, Executive Director, Enforcement, addresses the Pan Asian Regulatory Summit 2017

- The CFI ordered Tong Shek Lun, former chairman and director of Starlight Culture Entertainment Group Limited, Ko Lai King Kinny and Chung Wai Yu Regina, two other former executive directors, to pay compensation of around US\$890,000 for their misconduct relating to a disposal of subsidiaries by Starlight in September 2008, and disqualified them for five to seven years.

Insider dealing and market manipulation

Key enforcement actions included:

- The CFI, by consent, ordered Sun Min to pay over \$15.6 million to 51 investors affected by her insider dealing in the shares of China Huiyuan Juice Group Limited.
- The CFI, by consent, ordered Augustine Cheong Kai Tjeh, a former senior executive of an affiliate of Titan Petrochemicals Group Limited, and his mother Gan Ser Soon, to pay investors for their insider dealing in the shares of Titan in 2012.
- The Court of Appeal (CA) upheld the decision of the CFI which ruled in favour of the SFC's insider dealing and fraud case against two solicitors, Betty Young Bik Fung and Eric Lee Kwok Wa, and Lee's two sisters. In March 2018, the CA granted leave to Lee and his two sisters for taking their case to the Court of Final Appeal (CFA) in relation to the interpretation of section 300 of the SFO arising from fraudulent or deceptive transactions involving foreign securities.

- The CA dismissed our leave application to appeal to the CFA against the MMT's findings that Yiu Hoi Ying and Marian Wong Nam, two former executives of Asia Telemedia Limited, had not engaged in insider dealing. In February 2018, our leave application was granted by the CFA on the basis that the questions we raised are of great general or public importance.
- We commenced criminal proceedings against Au-Yeung Siu Pang for alleged insider dealing in the shares of China CBM Group Company Limited by selling, and counselling or procuring another person to sell China CBM shares in March 2012.
- We issued restriction notices to four securities firms relating to suspected market manipulation by their clients. The SFC was not investigating these brokers, which cooperated with our investigation.
 - Caitong International Securities Co., Limited, Pacific Foundation Securities Limited and Yuanta Securities (Hong Kong) Company Limited were prohibited from dealing with or processing assets held in client accounts which are related to suspected market manipulation in the shares of GME Group Holdings Limited.
 - Interactive Brokers Hong Kong Limited was prohibited from dealing with or processing assets held in a client account which is related to suspected insider dealing in the shares of Bloomage BioTechnology Corporation Limited.

Intermediary misconduct

During the year, we disciplined 15 corporations, two responsible officers and 14 licensed representatives, resulting in total fines of \$483 million. Key disciplinary actions included:

- HSBC Private Bank (Suisse) SA was fined a record sum of \$400 million after the Securities and Futures Appeals Tribunal (SFAT) upheld our disciplinary action against the bank for material systemic failures in the sale of structured products in the run-up to the global financial crisis in 2008 (see sidebar on page 63).

Record fine for failures in selling structured products

In November 2017, the SFAT upheld our findings and fined HSBC Private Bank (Suisse) SA^a \$400 million for material systemic failings in the sale of Lehman Brothers-related structured notes (LB-Notes) and leveraged forward accumulators which caused substantial losses to clients. The bank was also suspended from advising on securities for one year and partially suspended from dealing in securities.

While investigating over 80 investor complaints^b, we found material systemic deficiencies in the bank's sale of these products. The bank was aware of Lehman Brothers' deteriorating financial condition and had materially reduced its own exposure. Nevertheless, it continued to sell LB-Notes up to two weeks before Lehman Brothers' September 2008 collapse without disclosing the identity of the issuer or providing warnings to clients about the increasing credit risk during the sales process.

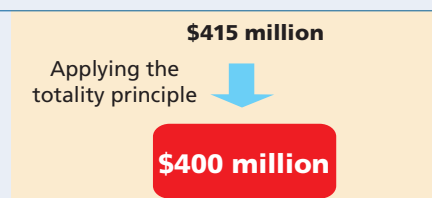
Although the bank assigned LB-Notes the riskiest rating, it allowed clients categorised with low or medium risk tolerance levels to purchase them without keeping proper records of the justifications for allowing these transactions. It also failed to implement adequate systems and controls to prevent clients from being overly exposed to accumulators.

The SFAT's determination confirms our approach in imposing a fine for each area of culpable conduct and using the number of complaints as the multiplier in assessing the appropriate fine^c (see the diagram below). The record fine is a stern warning for regulated persons to adhere to principles of professional conduct.

Our standards are designed to protect all investors including clients of retail or private banks. We will take action when breaches of the standards occur and substantial sanctions may result.

Calculating the fine

Nature of misconduct	Fine for each act of misconduct		Number of affected complainants		Total
LB-Notes: Failures to inform clients of issuer risk	\$5 million	X	15	=	\$75 million
LB-Notes: Suitability failures	\$5 million	X	55	=	\$275 million
Leveraged forward accumulators: Suitability failures	\$5 million	X	13	=	\$65 million



^a HSBC Private Bank (Suisse) SA is a registered institution under the SFO to carry on business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities.

^b Referred by the Hong Kong Monetary Authority.

^c Using the number of complaints as the multiplier may not be appropriate in every case. The appropriate approach in each case will depend on its facts.

Enforcement

- We reprimanded and fined Guoyuan Securities Brokerage (Hong Kong) Limited \$4.5 million for failing to conduct proper enquiries to mitigate the risks of money laundering and terrorist financing when processing third-party fund transfers for clients.
- UBS Securities Asia Limited was reprimanded and fined \$4.5 million for failing to put in place effective controls to record transactions and client consents for its facilitation trading activities.
- Promising Securities Company Limited was reprimanded and fined \$3.5 million for allowing unlicensed staff to perform regulated functions and failing to ensure the effective segregation of sales and settlement, giving the settlement staff an opportunity to misappropriate client assets.
- We reprimanded and fined iSTAR International Futures Co. Limited⁶ \$3 million for failing to comply with anti-money laundering and counter-terrorist financing requirements when processing third-party fund transfers, while Wu Biwei, its former responsible officer and managing director, was suspended for six months.
- The CFA granted leave to Moody's Investors Service Hong Kong Limited to appeal in the matter of our disciplinary action in relation to its special comment report published in 2011.
- CLSA Limited was reprimanded and fined \$9 million for its internal control failures in its client facilitation services and its reporting obligations⁷. In making the determination, we took into account that CLSA undertook a review with the SFC to address our regulatory concerns and cooperated in resolving them, and that CLSA's board of directors pledged to take reasonable steps to rectify its internal control failures in relation to avoidance of conflicts of interest.
- Deutsche Bank AKTIENGESELLSCHAFT and its wholly-owned subsidiary Deutsche Securities Asia Limited were reprimanded and fined a total of \$8.3 million over their regulatory breaches related to short position reporting, unlicensed regulated activities and segregation of client monies. In making the determination, we considered the two companies' cooperation and remedial measures to strengthen internal controls and systems.
- We reprimanded and fined Interactive Brokers Hong Kong Limited \$4.5 million for failures related to its electronic and algorithmic trading systems. In making the determination, we considered the firm's cooperation and that it agreed to arrange an independent review of these systems.

We also secured convictions for breaches of the SFO by two corporations:

In four cases, we took disciplinary action against the following corporations after resolving our concerns with them:

- Credit Suisse (Hong Kong) Limited, Credit Suisse Securities (Hong Kong) Limited and Credit Suisse AG were reprimanded and fined a total of \$39.3 million over a series of internal control failures, including in segregating client securities and in ensuring product suitability. In making the determination, we considered Credit Suisse's agreement to engage an independent reviewer to investigate our regulatory concerns and review their internal controls, as well as their cooperation.
- ETRADE Securities (Hong Kong) Limited was convicted of actively marketing to the Hong Kong public US brokerage services provided by E*TRADE Securities LLC, which was not licensed by the SFC. This was the first criminal conviction secured by the SFC against a firm for marketing unlicensed activities carried out outside Hong Kong.
- QMIS Securities Limited and its former responsible officer, Huang Kuang Cheng, were convicted and fined for making false or misleading representations when submitting licensing information to the SFC.

⁶ Now known as Rifa Futures Limited.

⁷ Intermediaries are required to report to the SFC immediately about any suspected or actual material breach of any applicable legal and regulatory requirements by themselves or persons they employ or appoint to conduct business with clients under the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

Other disciplinary actions

Unauthorised trading

Company/Name	Conduct	Action	Date
Danny Fung Kwong Shing	Conducted 772 unauthorised transactions in his client's account and fabricated telephone order recordings to mislead his employer	Fined \$542,071 and banned from re-entering the industry for life	23.11.2017
Shum Kam Ming	Conducted unauthorised transactions in a client's account and provided false account statements	Banned from re-entering the industry for life	25.9.2017
Yeung Leung Yuen	Conducted unauthorised transactions in a client's account	Banned from re-entering the industry for three years	7.11.2017
Tsap Wai Ping	Caused invitations to subscribe for shares in the US to be issued to the investing public without authorisation from the SFC	Banned from re-entering the industry for two years	19.5.2017

Criminal conviction

Company/Name	Conduct	Action	Date
Daniel Chen Chi Lik	Convicted of theft	Banned from re-entering the industry for life	20.4.2017

Internal control failures

Company/Name	Conduct	Action	Date
Standard Chartered Securities (Hong Kong) Limited	Internal control failures related to short-selling orders and regulatory breaches	Reprimanded and fined \$2.6 million	18.12.2017
EFG Bank AG	Failure to ensure compliance with regulatory requirements when dealing in futures contracts	Reprimanded and fined \$2 million	11.1.2018

Enforcement

Regulatory breaches

Company/Name	Conduct	Action	Date
FXCM Asia Limited ^a	Failure related to under-segregation of client money and regulatory breaches	Reprimanded and fined \$2 million	13.12.2017
Yip Ka Ying, Abbie	Attempted to conceal a trade execution error and trading loss from her employer	Banned from re-entering the industry for 18 months	13.12.2017

^a Now known as Rakuten Securities Hong Kong Limited.

Note: See Table 6 in Breakdown of SFC activity data on pages 163-169 for details of the less significant disciplinary actions.

Enhanced cooperation

We are actively developing a long-term strategic relationship with the China Securities Regulatory Commission (CSRC) to ensure effective enforcement collaboration in surveillance and joint investigations. During the year, we held regular high-level meetings, organised a staff secondment programme and hosted a CSRC-SFC joint training workshop in Xiamen. In December 2017, we entered into a memorandum of understanding (MoU) on supervisory and enforcement cooperation concerning futures, which enhances supervisory assistance, enforcement cooperation and information exchange relating to cross-boundary derivatives as well as futures exchanges and brokers.

Locally, we signed an MoU with the Hong Kong Police in August 2017 to formalise and strengthen cooperation in combating financial crime. We also closely collaborated with the Hong Kong Monetary Authority to investigate authorised institutions' misconduct under the SFO and with the Department of Justice on securities fraud, insider dealing, market manipulation and other offences.

In December 2017, we issued an updated Guidance Note on Cooperation with the SFC to highlight the benefits of cooperating in our investigations and enforcement proceedings. New measures encourage cooperation which helps the SFC investigate more serious legal or regulatory breaches and achieve timely and desirable enforcement outcomes. At the same time, we updated our Disciplinary Proceedings at a Glance guide.

New system to manage large volume of documents

Enforcement cases have become more complex and many now involve significant quantities of data and documents.

In early 2017, we enhanced our litigation support system to provide a centralised platform to manage data and documents for investigation and litigation purposes across the entire organisation.

The system enables us to search, review and analyse a large amount of litigation-related data more easily and to prepare exhibits for court proceedings more efficiently.

In addition, more users from different divisions can now readily access and review information in the system on an as-needed basis, facilitating cross-divisional cooperation.

Since its launch, more than 600 cases were handled using the enhanced system and over seven million documents were uploaded.

Enforcement activities

	2017/18	2016/17	2015/16
S179 ¹ inquiries commenced	24	27	24
S181 ² inquiries commenced (number of letters sent)	261 (8,461)	301 (8,960)	286 (7,997)
S182 ³ directions issued	274	407	507
Investigations started	280	414	515
Investigations completed	254	591	436
Individuals/corporations charged in criminal proceedings	14	10	20
Criminal charges laid ⁴	54	46	107
Notices of Proposed Disciplinary Action ⁵ issued	29	49	35
Notices of Decisions ⁶ issued	32	56	42
Individuals/corporations subject to ongoing civil proceedings	97	126	100
Compliance advice letters issued	277	548	453
Cases with search warrants executed	22	34	31

¹ 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.

² 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.

³ Section 182 of the SFO gives the SFC the power to investigate SFO offences, market misconduct, fraud, misfeasance and disciplinary misconduct.

⁴ The SFC brought a total of 54 criminal charges against 11 individuals and three corporations.

⁵ 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.

⁶ 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 pages 163-169 for more details.

Risk assessment

As markets become more complex and interconnected, we adopt a holistic, structured approach to assessing risk using new regulatory technologies to collect and analyse large volumes of data and information.

Identifying interconnected parties

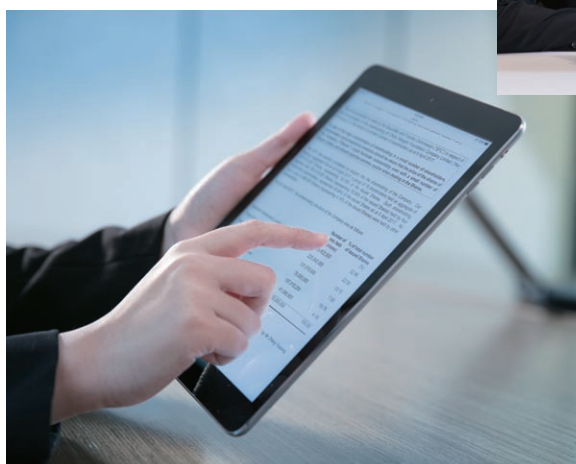
The Market Intelligence Programme uses the latest technologies to enhance our capability to identify conduct risks in our markets, including potential misconduct by interconnected parties. Data collected from our operations and public sources is analysed to isolate patterns and connections between individuals, companies and transactions which may indicate conduct risks.

Diving deep in the data

By applying new data analytic technologies and techniques to complex issues, the newly-established Data Analytics Group will allow us to carry out more effective market surveillance as well as to monitor and address prudential and systemic risks in a comprehensive manner.

Monitoring market dynamics

The Risk Review Group brings together staff with a variety of expertise from across the organisation to monitor market risks as well as market development opportunities and to understand the potential business and regulatory implications of new and emerging issues, particularly those which may pose challenges to our regulatory and supervisory efforts.



Global regulatory engagement

We actively participate in global regulatory policymaking through our involvement in international standard-setting bodies and our engagement with overseas counterparts.

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. Since our Chief Executive Officer Mr Ashley Alder was appointed as Chairman of the IOSCO Board¹ in May 2016, we worked closely with the IOSCO Secretariat to enhance the relevance of IOSCO's work to the Board and the wider membership as well as to coordinate the policy work of IOSCO and the Financial Stability Board (FSB).

This year, the IOSCO Board discussed a wide range of issues including market conduct, initial coin offerings (ICOs), cybersecurity, financial technologies (Fintech), sustainability reporting, the European Union (EU) Data Privacy Regulation, asset management and the use of behavioural insights in retail investor protection. In May 2018, Mr Alder was reappointed as Chairman of the IOSCO Board for a two-year term.

- In June 2017, the IOSCO Task Force on Market Conduct, also chaired by Mr Alder, issued its final report on the tools and approaches used by IOSCO members to discourage, identify, prevent and sanction misconduct by individuals in wholesale markets.
- In January 2018, the IOSCO Board issued a public statement highlighting the risks related to ICOs. We also participated in IOSCO's ICO Consultation Network and the IOSCO Working Group on Data Analytics.

The SFC is represented in all eight IOSCO policy committees, the Assessment Committee, the Committee on Emerging Risks and all key task forces and working groups.

- During the year, a Director of Intermediaries Supervision joined the Committee on Regulation



IOSCO Board meeting in Madrid

of Market Intermediaries which discussed retail over-the-counter (OTC) leveraged products and conflicts of interest during the capital-raising process.

- As a member of the Committee on Investment Management, we take part in initiatives including formulating and publishing IOSCO's recommendations and good practices to improve liquidity risk management for collective investment schemes. We also chair a new workstream on exchange-traded funds to identify key issues and risks which may require IOSCO's further oversight or action.
- We actively participate in the Committee on Enforcement and the Exchange of Information and the Multilateral Memorandum of Understanding Screening Group, which aims to prevent and detect breaches of securities laws and regulations in global financial markets. We also undertake a number of initiatives to support the implementation of the Enhanced MMoU² to foster greater cross-border enforcement cooperation and assistance among securities regulators.

Mr Alder co-chairs the Committee on Payments and Market Infrastructures (CPMI) – IOSCO Steering Group, which coordinates regulatory policy work, including oversight and supervision, related to central counterparties and the monitoring of the implementation of the Principles for Financial Market Infrastructures³.

¹ IOSCO's governing and standard-setting body.

² The Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information, established in 2017, provides a mechanism for sharing investigative material and providing assistance with respect to alleged misconduct.

³ These are the international standards issued by IOSCO and the CPMI for financial market infrastructures to strengthen financial stability.

Global regulatory engagement

Financial Stability Board

As an active participant in the work of the FSB, we maintain close collaboration with the Hong Kong Monetary Authority, Insurance Authority and the Government of the Hong Kong Special Administrative Region (HKSAR) on FSB initiatives related to the securities sector.

- As Chairman of the IOSCO Board, Mr Alder is a member of the FSB's Plenary and its Steering Committee, which focus on monitoring the progress of the Group of Twenty (G20) reforms including those related to cybersecurity, misconduct risks and market-based finance. We also sit on the FSB's Standing Committee on Standards Implementation (SCSI) and participate in its Implementation Monitoring Network, which considers the effects of the G20 reforms.
 - To ensure the views of Asian markets and securities regulators are reflected in policy recommendations, we are a member of the FSB Regional Consultative Group for Asia, to which we contribute views on policy from Hong Kong's perspective.
 - During the year, we participated in various FSB workstreams and exercises, including the *Global Shadow Banking Monitoring Report 2017* and surveys on financial stability and cybersecurity and crypto-assets. We took part in the FSB Working Group on Governance Frameworks which focuses on mapping the responsibilities of senior management to mitigate misconduct risk. We also participated in the FSB Cyber Lexicon Working Group to foster a common understanding of cybersecurity terminology across the financial sector.
 - We are a member of the FSB's Workstream on Other Shadow Banking Entities, contributing to the implementation of the FSB's January 2017 recommendations to address vulnerabilities in asset management activities, including liquidity mismatches between fund investments and the redemption terms and conditions for open-ended fund units, and leverage within investment funds.
- Together with the HKSAR Government and other Hong Kong financial regulators, we responded to a peer review conducted by the SCSI covering Hong Kong's implementation of OTC derivatives market reforms and its resolution framework for financial institutions. Published in February 2018, the peer review noted that Hong Kong made good progress in both areas.

Mainland China

We work closely with Mainland authorities to support Hong Kong's long-term strategic development as Mainland financial markets continue to open up. We regularly hold high-level discussions with the China Securities Regulatory Commission (CSRC) on Stock Connect, cross-boundary enforcement and supervisory cooperation. Working groups were established to follow up on various cooperation initiatives. We also discussed regulatory updates and supervisory cooperation with the China Banking Regulatory Commission⁴.

In November 2017, together with the Financial Secretary Mr Paul Chan and Secretary for Financial Services and the Treasury Bureau Mr James Lau, our Chairman Mr Carlson Tong met with CSRC Chairman Mr Liu Shiyu in Beijing to discuss the development of Hong Kong's financial markets and regulatory cooperation with the Mainland.



High-level meeting with the CSRC in September 2017

⁴ The China Banking Regulatory Commission and the China Insurance Regulatory Commission were merged in April 2018 to form the China Banking and Insurance Regulatory Commission.

In the same month, we reached an agreement with the CSRC on proposals to introduce an investor identification regime for northbound trading under Stock Connect. We entered into a memorandum of understanding (MoU) in December 2017 on supervisory and enforcement cooperation on matters concerning futures. We also met with the CSRC to exchange information on Hong Kong brokers' preparedness to trade products listed on the Shanghai International Energy Exchange.

This year saw the launch of Bond Connect, the increase of the daily quotas under Stock Connect⁵ and the expansion of Hong Kong's Renminbi Qualified Foreign Institutional Investor investment quota⁶ following our high-level discussions with Mainland authorities.



SFC-CSRC enforcement cooperation meeting

Enforcement cooperation with the Mainland

We strengthened our collaboration with the CSRC following the introduction of new programmes providing for mutual market access between Hong Kong and the Mainland. Prior to the launch of Shanghai-Hong Kong Stock Connect, we established an enforcement cooperation mechanism^a which enables the exchange of information and intelligence with Mainland regulators. Since then, we collaborated extensively with the CSRC on cross-boundary enforcement to ensure orderly market operations and investor protection in both markets.

In December 2017, we held the fifth regular SFC-CSRC high-level meeting on enforcement cooperation, including investigations of major cases, as well as ways to enhance the implementation of the Stock Connect MoU and make cross-boundary enforcement cooperation more efficient. Other topics on the agenda were information notifications, evidence handling, staff exchanges and joint training.

^a In October 2014, the SFC and the CSRC signed an MoU on strengthening cross-boundary regulatory and enforcement cooperation under Shanghai-Hong Kong Stock Connect.

We engaged in discussions with Mainland authorities to formulate new Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) measures⁷ relating to the securities sector. These included enhancing the mechanism for closer financial cooperation and cross-boundary renminbi fund flows, expanding the scope of eligible securities under Stock Connect, assessing the progress of the Mainland-Hong Kong Mutual Recognition of Funds scheme as well as supporting the development of offshore risk management business. During the year, the CSRC granted approval for two Hong Kong financial institutions to set up multi-licensed joint venture securities companies on the Mainland.

We actively support the HKSAR Government in strengthening Hong Kong's cooperative relationship with Guangdong, Beijing, Shanghai and other regions to facilitate access to the Mainland market by Hong Kong's financial services sector.

We organised five training programmes and seminars for senior executives from Mainland authorities and organisations to enhance their understanding of our regulatory work. In December 2017, the SFC and the CSRC co-organised a case study training session in Xiamen where both regulators and the US Securities and Exchange Commission shared their experience in investigating breaches of disclosure rules, fraudulent offerings and market manipulation.

⁵ The new daily quotas are RMB52 billion for each of the northbound trading links and RMB42 billion for each of the southbound trading links with effect from 1 May 2018.

⁶ The quota was increased from RMB270 billion to RMB500 billion on 4 July 2017.

⁷ Two new CEPA agreements – the Investment Agreement and the Agreement on Economic and Technical Cooperation – were signed between the HKSAR Government and the Mainland's Ministry of Commerce on 28 June 2017 and implemented on 1 January 2018.

Global regulatory engagement



Fintech cooperation agreement with FINMA

Bilateral agreements

We collaborate with overseas counterparts to keep abreast of emerging regulatory issues. During the year, we signed separate Fintech cooperation agreements with the UK Financial Conduct Authority (FCA), Australian Securities and Investments Commission, Dubai Financial Services Authority, Securities Commission Malaysia and the Swiss Financial Market Supervisory Authority (FINMA).

In July 2017, we entered into an MoU with the UK FCA providing for consultation, cooperation and information exchange in the supervision of regulated entities which operate on a cross-border basis in Hong Kong and the UK.

We signed an MoU with Autorité des Marchés Financiers in the same month to allow eligible French and Hong Kong public funds to be distributed in each other's market through a streamlined vetting process.

In November 2017, we attended the ninth MoU meeting with the Taiwan Financial Supervisory Commission to discuss topics including anti-money laundering and Fintech regulation.

Other engagement

In December 2017, we hosted the second EU-Asia Pacific Forum on Financial Regulation, co-chaired by Mr Alder, in Hong Kong. Regulators from the EU and the Asia-Pacific region discussed the cross-border regulatory implications of EU regulations, sustainable finance, Fintech, asset management and fund passporting.

Effective 18 August 2017, Mr Tong and Mr Alder were appointed members of the Financial Leaders Forum for a two-year term. Set up by the HKSAR Government, the forum provides a platform to discuss strategic and forward-looking proposals to strengthen Hong Kong's position as an international financial centre.

We maintained regular dialogues with overseas regulators including the Swiss FINMA and the US Federal Reserve to share intelligence and updates on the supervision of global financial institutions. We also participated in regional supervisory colleges to discuss the oversight of global investment banks with our regulatory counterparts.

In August 2017, we entered into an MoU with the Hong Kong Police to formalise and strengthen cooperation in combating financial crime. The MoU covers case referrals, joint investigations, investigative assistance and the exchange and use of information, and establishes a framework for closer collaboration on policy, operational and training issues.

We handle investigatory requests from and send requests to overseas regulators under various cooperative arrangements⁸.

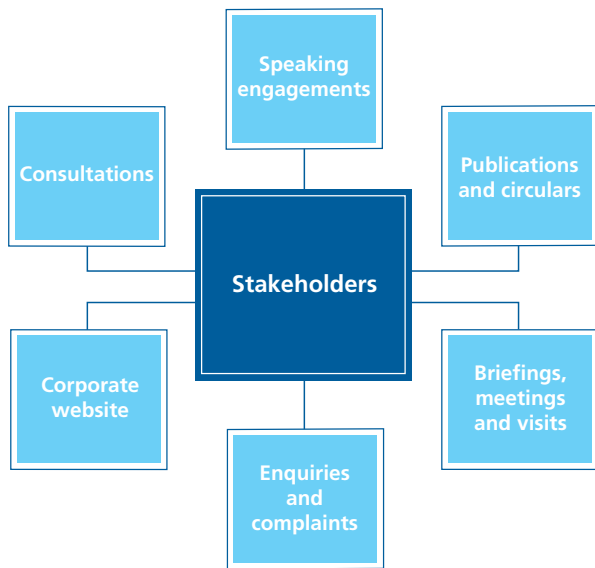
Requests for regulatory cooperation

	2017/18		2016/17		2015/16	
	Received	Made	Received	Made	Received	Made
Enforcement-related requests for assistance	136	104	155	112	92	160
Licensing-related requests for assistance	112	1,178	125	1,101	124	1,104

⁸ Including the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information which was established in 2002.

Stakeholder communication

We strive to help stakeholders understand our work and provide them with up-to-date regulatory information through timely, concerted and effective outreach. We use multiple channels to engage with a wide range of stakeholders.



Industry

In March, we organised the SFC Regulatory Forum 2018 attended by around 900 participants from the financial industry, listed companies and regulatory and professional bodies. This biennial event is a platform for us to discuss the latest regulatory developments with our stakeholders (see sidebar on pages 76-77).

We maintain an open and productive dialogue with industry associations, professional bodies and other market participants. We also regularly organise meetings and briefings to keep industry participants informed about regulatory developments.

When we propose rules under the Securities and Futures Ordinance (SFO), 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, before they are implemented. We issue consultation papers containing detailed proposals and hold both formal and informal discussions with relevant stakeholders to seek their views as part of the consultation process.

Publications and other communications

	2017/18	2016/17	2015/16
Press releases	138	134	114
Consultation papers	11	4	5
Consultation conclusions	8	2	9
Industry-related publications	15	13	11
Codes and guidelines ^a	10	4	3
Circulars to industry	83	74	68
Corporate website average daily page views ^b	67,664	59,952	51,020
General enquiries	7,494	6,532	7,033

^a Includes updates to previous versions.

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

Stakeholder communication



SFC Chairman Mr Carlson Tong at the HSBC Financial Dialogue Series 2018

After completing our analysis, we issue a consultation conclusions paper summarising the main comments received and setting out our conclusions. We published 11 consultation papers and eight consultation conclusions in the year.

During the year, our senior executives took part in 83 speaking engagements on various topics within our remit. We supported 13 seminars or events organised by industry bodies.

In October 2017, our senior executives spoke at a full-day programme we organised with the Hong Kong Monetary Authority (HKMA) to discuss regulatory issues related to financial technology (Fintech) development. The programme was part of Hong Kong Fintech Week sponsored by InvestHK. We also engaged with a wide range of stakeholders including financial institutions, industry organisations and start-ups through the SFC Fintech Contact Point¹, which handled 112 enquiries during the year.

Our publications aim to update the industry on our regulatory work, topical issues and other developments. This year, we published 15 thematic publications, including periodic newsletters, market reviews and surveys.

We launched two new publications during the year. The *SFC Regulatory Bulletin: Listed Corporations*, launched in July 2017, provided guidance on the manner in which we perform some of our functions under the Securities and Futures (Stock Market Listing) Rules and the SFO regarding listed corporations and other listing matters. In December 2017, the first edition of the *SFC Compliance Bulletin: Intermediaries* reminded the industry of the importance of managing conflicts of interest in selling practices and asset management.

Circulars and frequently-asked questions are posted on the SFC website to help the industry better understand our regulatory requirements. This year, we issued 83 industry circulars informing industry participants about various matters, including anti-money laundering, over-the-counter derivatives transactions, investment product distribution, securities margin financing and regulated activities involving cryptocurrency-related products and derivatives.

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.

¹ The SFC Fintech Contact Point was launched in March 2016 as a dedicated portal to receive enquiries and requests related to Fintech.



Hong Kong Fintech Week 2017

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

Regulatory counterparts

We play an active role in international regulatory cooperation through our participation in both the International Organization of Securities Commissions and the Financial Stability Board².

To enhance regulatory cooperation, 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 more than 40 MoU meetings. In addition, we signed five cooperation agreements with overseas regulators on the development and application of Fintech, and received visitors and delegates from Mainland and overseas authorities.

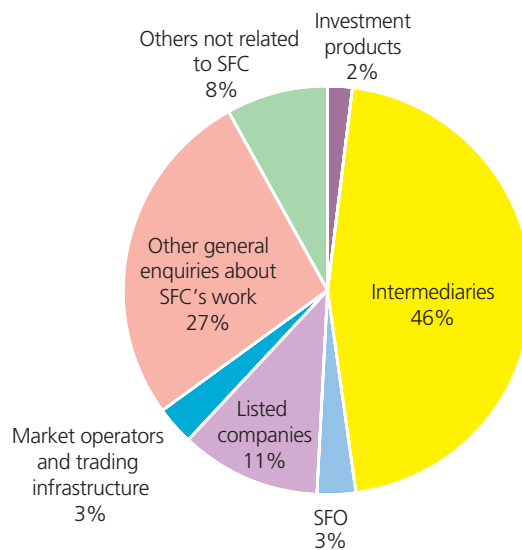
The public

We address public concerns and enquiries regarding the securities and futures markets. During the year, we received a total of 7,494 general enquiries by phone or in writing.

Complaints against intermediaries and market activities are first reviewed by our Complaints Control Committee, comprising senior executives from across the organisation, and are allocated to responsible divisions for assessment where appropriate.

We handled 2,689 complaints during the year. A total of 1,256 cases³ were allocated for further review and 516 were referred to Hong Kong Exchanges and Clearing Limited or other financial regulators and law enforcement agencies.

General enquiries



² See Global regulatory engagement on pages 69-72.

³ One case may comprise multiple complaints.

SFC Regulatory Forum 2018

The third SFC Regulatory Forum, our biennial event, took place on 14 March 2018. The event centred on initiatives to enhance the competitiveness of Hong Kong as a capital-raising centre amidst rapid technological innovation and increasing connectivity with the Mainland and other markets.

The event kicked off with opening remarks from our Chairman, Mr Carlson Tong, who emphasised the importance of attracting a greater variety of listed companies and collaborating more closely with both local and overseas regulators.

The keynote address by Mr Paul Chan, Financial Secretary of the Government of the Hong Kong Special Administrative Region, highlighted the Government's initiatives to promote the development of financial services and enhance Hong Kong's competitiveness as an international financial centre. Mr Chan stressed that Hong Kong needs to be innovative and proactive to remain competitive and maintain its growth momentum.

Hong Kong is not only a super-connector to mainland China – we have also been playing a very important risk management role from a policy perspective.

*Au King Lun, Chief Executive Officer,
Value Partners Group Limited*



The first of four panel discussions addressed ongoing reforms to listing regulation in Hong Kong in the context of the SFC's front-loaded, real-time approach and the evolving relationship between Hong Kong and Mainland capital markets. Our Chief Executive Officer Mr Ashley Alder stressed that effective regulation and reciprocal, balanced regulatory cooperation are vital to further market integration and expand global investment flows.

In this age of advanced technology, the industry needs to move fast to provide the public with the convenience they need and a better overall experience with financial services.

*Chu Gang, Chief Operating Officer and
Chairman of Capital Markets Committee,
China International Capital Corporation Limited*





Another panel considered the opportunities and challenges facing the asset management industry in view of recent cross-border initiatives. Panellists also weighed the potential for Hong Kong to develop as the region's premiere risk management centre and derivatives hub as the city plays an increasingly important role in connecting the Mainland and the rest of the world.

Mainland China will be the largest source of new listings and capital flows for Hong Kong in the years to come and the key strategy to drive this is to raise corporate governance standards in Hong Kong.

Yin Ke, Chief Executive Officer, CITIC Securities International Company Limited

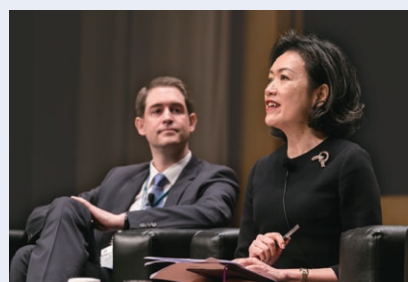
In the third panel, speakers discussed the role of regulation in changing corporate behaviour and the need for changes in listing regulation to deal with the most pressing problems, particularly shell manufacturing and backdoor listings, as well as the role of independent non-executive directors.

The last panel addressed our recent efforts to ensure intermediaries' compliance (eg, senior management responsibilities and accountability) and deter corporate fraud and market misconduct. The discussions also covered how we are keeping up with the pace of technological change in the financial services industry.

Around 900 leaders from the financial industry, listed companies, professional services firms and industry associations attended the full-day event. Videos of the proceedings and a summary of discussions were posted on the SFC website.

We need to make sure that valuations fairly reflect the value of the underlying assets and that there are protections for minority shareholders and all shareholders are treated equally.

Manuel Schlabbers, Chief Executive Officer, Accudo Capital Limited



Stakeholder communication

We launched a new system which provides a one-stop platform for storing and processing information about the complaints we receive. With the new system, we can more easily access information, compile statistics, generate management reports and track the progress of complaints.

To increase public understanding of Hong Kong's financial regulatory framework and our regulatory role, we received visitors from local and overseas institutions and our senior executives delivered key messages in media interviews. We issued 138 press releases to inform the public of the latest regulatory actions and other SFC news.

We published our *Annual Report 2016-17* and three quarterly reports to help stakeholders understand our work. Our reporting efforts were recognised

with a Gold prize in the Hong Kong Management Association's Best Annual Reports Awards 2017, and a Gold award, public sector category, in the Hong Kong Institute of Certified Public Accountants' 2017 Best Corporate Governance Awards.

The public can easily obtain up-to-date information about our work and regulations on our corporate website. This year we made enhancements to facilitate access to information. To provide easier access to licensing information, we published a comprehensive *Licensing Handbook* on our website and made webpages more user-friendly. We also enhanced our homepage and other sections to improve web accessibility for users with visual or hearing disabilities.

Handling complaints and enquiries with aplomb

We strive to responsibly and professionally address complaints and enquiries regarding the markets. Our efforts were recognised during the year when Sam Chiu, Manager, External Relations, Corporate Affairs, received The Ombudsman's Awards 2017 for Officers of Public Organisations for his outstanding work in this area.

Chiu, who handles public complaints and enquiries on a daily basis, says he always tries his best to help investors understand our rules and regulations. Putting himself in their shoes helps him better understand where they are coming from.

The work can be challenging in some cases where we cannot provide certain details of our work due to secrecy provisions in the law. Nonetheless, he adds, quality complaints are a valuable channel for us to learn about market misconduct and regulate the markets more effectively.

One of the most memorable cases Chiu handled during his seven years at the SFC began with a call he received about a broker failing to return client securities.

This led to immediate regulatory action including a restriction notice on the broker to preserve its clients' assets.

In receiving his award, Chiu credited the support of his supervisors and team members for helping him excel in his role.



When the public contacts us with complaints and enquiries, we have the responsibility to help them understand the markets we regulate.

Sam Chiu

Complaints against intermediaries and market activities

	2017/18	2016/17	2015/16
Conduct of licensees	357	411	338
Conduct of registered institutions	22	39	34
Listed companies and disclosure of interests	779	739	631
Market misconduct ^a	322	221	265
Product disclosure	12	8	9
Unlicensed activities	141	116	128
Breach of offers of investments	48	141	21
Boiler rooms and suspicious websites	319	330	310
Scams and frauds ^b	186	132	100
Other financial activities not regulated by SFC ^c	503	185	220
Total	2,689	2,322	2,056

^a Primarily, alleged market manipulation and insider dealing.

^b Such as identity fraud and impersonation.

^c For example, bullion trading, banking complaints.

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 163-169 for more details.

