

Operational Review

Intermediaries

Licensing

In the quarter, we received 1,953 new licence applications, down 17% from the last quarter and up 1.5% year-on-year. The number of corporate applications for new licences decreased 25.9% from the last quarter to 63, down 35.7% year-on-year.

As at 31 December, the number of licensees and registrants totalled 46,371, up 5% from last year, and the number of licensed corporations grew 9.2% to 2,905.

Beginning 26 November, approval letters are only sent to individual licence applicants electronically, copying their accredited licensed corporations, and not in paper form.

Licensing applications

	Quarter ended 31.12.2018	Nine months ended 31.12.2018	Nine months ended 31.12.2017	YoY change (%)
Applications to conduct new regulated activity	5,593	18,731	16,992	10.2
Applications for SFC licences [#]	1,953	6,337	5,750	10.2

[#] Figures do not include applications for provisional licences. During the quarter, we received 1,054 provisional licence applications compared with 942 in the same quarter last year.

Regulatory enhancements

Financial resources rules

In October, we issued consultation conclusions on proposed amendments to the Securities and Futures (Financial Resources) Rules to update the computation basis for the financial resources requirements and ensure the rules are compatible with the latest market developments. The new requirements were enacted on 12 December. The amendments related to a new accounting standard took effect on 1 January 2019 and the remaining amendments will come into effect on 1 April 2019.

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Licensees and registrants

	As at 31.12.2018	As at 31.3.2018	Change (%)	As at 31.12.2017	YoY change (%)
Licensed corporations	2,905	2,702	7.5	2,660	9.2
Registered institutions	117	120	-2.5	119	-1.7
Licensed individuals	43,349	41,536	4.4	41,390	4.7
Total	46,371	44,358	4.5	44,169	5

Anti-money laundering

In October, we issued consultation conclusions on proposed amendments to the Guideline on Anti-Money Laundering and Counter-Financing of Terrorism (For Licensed Corporations) and the Prevention of Money Laundering and Terrorist Financing Guideline for Associated Entities. The changes align the guidelines with the latest international standards and make them more useful and relevant in light of industry developments. The revised guidelines came into effect on 1 November.

Complex products

We issued consultation conclusions in October on requirements for intermediaries to apply additional protective measures to the sale of complex products in an offline environment. These include ensuring their suitability and providing product information and warning statements to clients. As a consequence, identical protective measures will be applicable to both the online and offline sale of complex products with effect from April 2019.

Virtual assets

In a November statement, we set out a conceptual framework to explore whether virtual asset trading platforms are suitable for regulation. Further, in light of the significant risks virtual assets pose to investors, we will adopt new measures within our regulatory remit to protect those who invest in virtual asset portfolios or funds. We will impose licensing conditions on firms which manage or intend to manage portfolios investing in virtual assets¹, irrespective of whether the virtual assets meet the definition of “securities” or “futures contracts”². We also provided guidance on the standards expected of virtual asset portfolio managers and fund distributors.

OTC derivatives

In December, we released consultation conclusions on proposals to enhance the over-the-counter (OTC) derivatives regime and address conduct risks posed by dealings with group affiliates and other connected persons. New risk mitigation requirements for non-centrally cleared OTC derivative transactions take

¹ Where 10% or more of the gross asset value of the portfolio is invested in virtual assets.

² At present, many virtual assets do not meet the definition of “securities” or “futures contracts” under the Securities and Futures Ordinance (SFO). As such, managing funds solely investing in virtual assets which do not constitute “securities” or “futures contracts” does not amount to a “regulated activity” as specified under the SFO.

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effect on 1 September 2019, while client clearing requirements for OTC derivative transactions will become effective when the new Types 11 and 12 regulated activities come into effect. The conduct requirements to address risks posed by group affiliates and other connected persons take effect on 14 June 2019.

Non-exchange traded investment products

Our latest *Survey on the Sale of Non-exchange Traded Investment Products*, published in December³, showed that the aggregate transaction amount of investment products increased by 34% compared to the 2016 survey. As in the previous survey, structured investment products accounted for the largest share of the aggregate transaction amount, followed by fixed income products and collective investment schemes. By collecting information about the industry landscape and the types and value of investment products sold by licensed corporations, the survey helps us supervise selling practices.

In light of the significant increase in the sale of investment products such as equity-linked products and non-investment grade corporate bonds, we concurrently issued a circular reminding intermediaries to observe the requirements governing selling practices when they distribute structured products and corporate bonds with complex features or high risks.

Updated reporting arrangements

Revamped Business and Risk Management Questionnaire

We issued a revamped Business and Risk Management Questionnaire (BRMQ)⁴ in January 2019. For financial years ending on or after 31 March 2019⁵, licensed corporations and associated entities are required to complete and electronically submit the questionnaire to the SFC through WINGS⁶, the SFC's new online portal. The BRMQ collects information about the business operations of licensed corporations and associated entities as well as the specific measures they adopt to ensure sound risk management and proper internal controls. This enables the SFC to supervise licensed corporations and associated entities more effectively.

Electronic submission of notifications and annual returns

Starting 26 November, directors of licensed corporations or registered institutions and persons authorised by their boards can submit corporate notifications and annual returns⁷ via the SFC online portal. Previously, only responsible officers and executive officers were allowed to submit notifications and annual returns.

³ Previous surveys were published in 2012, 2014 and 2016.

⁴ All licensed corporations and associated entities are required to complete and submit the questionnaire to the SFC under section 156 of the SFO.

⁵ For financial years ending before 31 March 2019, the previous version of the BRMQ can be downloaded from the SFC's website and submitted in paper form.

⁶ Web-based INteGrated Service.

⁷ Registered institutions are not required to submit annual returns under the SFO.

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Monitoring

During the quarter, we conducted 72 on-site inspections of licensed corporations to review their compliance with regulatory requirements.

Promoting compliance

We issued a circular in October highlighting our concerns about the increasingly prevalent use of “nominees” and “warehousing” arrangements which may amount to market or corporate misconduct. Firms were reminded to be vigilant in identifying potential red flags which may suggest the use of these arrangements for illegitimate purposes and, where necessary, to make due follow-up enquiries with clients and report suspicious transactions promptly to the SFC and other authorities.

We issued a circular in November to announce a thematic review assessing the risk governance, oversight frameworks and risk management practices of selected licensed corporations in light of the increasing complexity of trading and business models. The review, combining industry surveys, meetings and on-site inspections, focuses on operational risk, data risk and the underlying risks of remote booking models.

Intermediary inspection

	Quarter ended 31.12.2018	Quarter ended 30.9.2018	Change (%)	Quarter ended 31.12.2017	YoY change (%)
On-site inspections conducted	72	81	-11.1	71	1.4

In December, we issued a circular and report to summarise the findings and highlight the key regulatory concerns identified during a circularisation exercise and high-level review of brokers’ control measures for protecting client assets along with a thematic review of brokers’ internal controls and supervision of account executives. We also published a comprehensive self-assessment checklist to help brokers review and improve these areas.

We issued a set of FAQs in December to clarify the application of the secrecy provisions under section 378 of the Securities and Futures Ordinance to the disclosure of supervisory information by licensed corporations to auditors, counsel, solicitors or other professional advisers.

We published the third issue of the *SFC Compliance Bulletin: Intermediaries* in November to highlight the SFC’s Fintech initiatives and recent regulatory developments.