Strategic Priorities

We aim to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures markets. As both a conduct regulator and a prudential regulator, our objectives are not limited to safeguarding the interests of investors and minimising fraud and market misconduct. Our role extends to maintaining Hong Kong's financial stability and mitigating systemic risk. To address emerging challenges and foster sustainable market development, we regularly modernise our regulatory framework and pursue close cooperation with our counterparts in Hong Kong, mainland China and overseas.

Mr Tim Lui, Chairman, at a Hong Kong Securities and Investment Institute event

Moving forward with targeted regulation

The new front-loaded regulatory approach we introduced in 2017 has allowed us to focus on the greatest risks facing our markets as well as to intervene at an earlier stage to address persistent problems and pre-empt the fallout from emerging threats.

We have implemented more changes in our organisation over the past few years than ever before. Acting as "One SFC", we pool our expertise to ensure our regulatory actions are coordinated, targeted and effective. We adopt the latest technology to help us collect and analyse data to manage evolving risks.

Intermediaries

The number of corporations and individuals licensed by us continues to rise. To ensure the effectiveness of our gatekeeping function, we modernised our licensing processes to make them more efficient and transparent. We now focus more on key risks and place greater emphasis on the competence of licensed individuals. Almost all of our licensing services are now available online, and in the coming year we will make our online licensing platform more user-friendly and efficient. We will also provide more guidance to the industry to ensure the changes we have made to our licensing regime are implemented smoothly.

We strive to drive and incentivise proper conduct to achieve good regulatory outcomes. Depending on the severity of our concerns, we deploy a range of tools including restriction notices, the imposition of licensing conditions and requests for voluntary undertakings to contain risks. We also conduct independent reviews of specific licensed corporations where necessary.

As part of our evolving risk-based supervisory approach, we conduct ongoing thematic reviews to focus on priority issues identified in our routine inspections. The themes reflect the priorities we set. Currently, these include IPO sponsors' work, book-building activities, securities margin financing, anti-money laundering, brokers' internal controls and supervision of account executives, cybersecurity, selling practices as well as complex and opaque financing arrangements. Our concerns and regulatory expectations as well as best practices noted in these reviews may be published in circulars or final reports to provide guidance to the industry.

Sales practices, in particular suitability, remain one of our top priorities. The products distributed to investors are now increasingly complex and include more structured products and high risk or complex bonds. We will review whether licensed corporations comply with the suitability obligations and new requirements governing the distribution of complex products.

We will work closely with the Hong Kong Government and other regulators to provide support to follow up on the recommended actions of the Financial Action Task Force and Asia/Pacific Group on Money Laundering mutual evaluation[1] report on Hong Kong, including to implement recommendations specific

[1] These evaluations, conducted on an ongoing basis, are peer reviews where members assess one another's systems for preventing illicit use of the financial system.

to the securities sector. In addition, we will review and update the risk assessment for the Hong Kong securities sector in the next Money Laundering and Terrorist Financing Risk Assessment.

Innovation and technology increasingly drive changes in financial markets, bringing both benefits and challenges. We take a facilitative approach to innovation where it is conducive to market efficiency and customer experience. Where innovation poses risks to investor protection, we act to manage them. We discuss the potential use of financial technology (Fintech) with interested firms through the SFC Fintech Contact Point and other channels. Our overall aim is to make sure our regulations remain effective as new technologies are introduced and any risks to investors or financial stability are properly managed. A few licensed firms are now operating in the SFC Regulatory Sandbox. We are also exploring whether and how we should regulate virtual asset trading platforms to protect investors against the risks of fraud and money laundering.

We will continue to upgrade our current data collection and analytical framework to enhance our capacity to conduct prudential risk assessment and improve the efficiency and effectiveness of our supervision. To improve our oversight of licensed corporations, we have stepped up our use of data analytics to monitor their resilience to market volatility as well as current trends and emerging issues. We run an automated stock alert and stress test system to identify thinly capitalised brokers and a similar system for futures and options brokers.

Listing matters

In the regulation of listing matters, and following a strategic review, since early 2017 we have exercised our statutory powers under the Securities and Futures (Stock Market Listing) Rules (SMLR)[2] and more generally under the Securities and Futures Ordinance (SFO) to directly intervene in more serious cases at an early stage. This enhances the protection of the investing public and suppresses illegal and improper market practices. It also complements our enforcement work aimed at pursuing wrongdoers, seeking remediation and deterring misconduct.

Tackling misconduct by listed companies remains a top priority. After our "ICE"[3] working group took steps to address price volatility in GEM stocks and GEM placings with a high concentration of shareholders, there was a sharp drop in the average first day price change of GEM listings, from a peak of about 530% in 2016 to around 22% in 2018. We also saw fewer instances of high shareholding concentrations in GEM stocks.

In the longer term, changing corporate behaviour will require further policy adjustments. We work closely with The Stock Exchange of Hong Kong Limited (SEHK) to develop listing policies to tackle new issues as market behaviour changes. Some measures to improve corporate conduct have already been introduced. These include tackling highly dilutive capital raising activities by tightening the listing rules for rights issues, open offers and specific mandate placings.

In the near term, our focus will be to enhance listing policies to discourage backdoor listings and "shell" related activities. We are also looking at arrangements which are commonly used for improper purposes such as warehousing of shares, where actual control is disguised through the use of nominees, and highly-concentrated shareholding structures.

To promote Hong Kong's position as an international financial centre and a listing venue of choice, we regularly review our IPO policies to ensure they remain globally competitive. A key focus is to explore options to streamline the IPO process, including shortening the IPO settlement timetable. We will continue our dialogue with SEHK on this issue.

Asset and wealth management

To further develop Hong Kong as one of the world's leading full-service asset and wealth management centres, we have reformed local regulations to align with international standards, fostered the development of new products and expanded the potential markets for Hong Kong public funds.

In the revised Code on Unit Trusts and Mutual Funds (UT Code) which took effect in January 2019, we

[2] Under the SMLR, we may raise objections to listing applications or direct SEHK to suspend trading in a listed company's shares.
[3] ICE (Intermediaries, Corporate Finance, Enforcement) is a cross-divisional working group set up to tackle corporate misconduct.

adopted an approach to regulating a fund's derivative investments which provides greater flexibility along with stronger safeguards. These include enhanced risk management and collateral requirements as well as a 50% limit for the net derivative exposure of "plain vanilla" funds. For investors, this means clearer product differentiation as well as improved protection through new distribution requirements.

The revised UT Code will facilitate the introduction of new fund types, such as active ETFs[4], and allow listed and unlisted share classes to co-exist within a single fund pursuing the same investment strategy. We also introduced a new open-ended fund company regime which will enable both public and private funds with variable capital to be established in corporate form in Hong Kong.

Meanwhile, we are identifying opportunities to enhance the transparency of information about retail funds and improve their comparability. To better monitor regulatory compliance, we launched an enhanced fund data reporting regime and are considering other changes to strengthen our reporting requirements for public funds.

As part of our ongoing efforts to safeguard market integrity, we are considering a new regulated activity regime for the safekeeping and custody of assets by trustees and custodians of SFC-authorised funds to better align with international standards and practices in major overseas jurisdictions. We are also conducting a holistic review of the Code on Pooled Retirement Funds to identify ways to enhance the protection of investors' interests and aim to launch a public consultation on proposals to update our regulatory requirements for these funds.

We remain committed to expanding the potential markets in which Hong Kong investment funds can be distributed, including exploring more Mutual Recognition of Funds (MRF) arrangements with overseas jurisdictions. Applications and approvals have increased for northbound Hong Kong funds under the Mainland-Hong Kong MRF scheme and we are working with the China Securities Regulatory Commission (CSRC) to enhance this regime so that a diversified pool of fund products managed in Hong Kong can be offered to Mainland investors.

Mr Ashley Alder, Chief Executive Officer, and Ms Julia Leung, Deputy Chief Executive Officer and Executive Director of Intermediaries at Hong Kong FinTech Week 2018

Markets

Another priority is to develop Hong Kong as a leading risk management centre. Because of the role it plays in intermediating cross-boundary capital flows, hosting the largest offshore renminbi centre and as a leading renminbi derivatives market, Hong Kong is uniquely positioned to manage Mainland risks for international investors and intermediaries. It can also play a key role in providing offshore hedging instruments for investors who choose to trade Mainland assets through Hong Kong.

We closely collaborate with the CSRC, Hong Kong Exchanges and Clearing Limited (HKEX) and other authorities to explore enhancements to Stock Connect, including widening the scope of eligible securities.

To ensure Hong Kong has a robust and resilient market infrastructure, we are working with HKEX to assess the regulatory implications of its new strategic plan and enhance its clearing risk management processes to align with international best practices and the expansion of its business. We are engaging with HKEX to review its volatility control mechanism (VCM)[5] in light of evolving international standards[6] and best practices. Together with HKEX, we are also studying the introduction of a market-wide circuit breaker. A public consultation will be conducted by HKEX in due course.

4 Exchange-traded funds.
5 The VCM imposes a price limit for trading in major constituent stocks and certain futures contracts for short periods under extreme price movements.
6 As recommended by the International Organization of Securities Commissions.

Separately, we are working on an investor identification model which covers all securities traded on or reported to SEHK and aim to consult the market on this proposal in the next few months.

An OTC derivatives regime[7] is being introduced in phases in Hong Kong. We are working on refinements to the scope of regulated activities under the OTC derivatives licensing regime and are conducting a review of the need for "masking" relief, which allows certain counterparty information to be redacted where there are legal or regulatory obstacles to reporting.

Our consultation on proposals to enhance the investor compensation regime by increasing the compensation limit from $150,000 to $500,000 per investor per default and covering northbound trading under Mainland-Hong Kong Stock Connect received strong support. We target to publish consultation conclusions in the second half of 2019 and implement the proposals subject to completion of the legislative process.

We issued a joint consultation paper with HKEX and the Federation of Share Registrars Limited in January 2019 proposing a revised operational model for a paperless securities market in Hong Kong. The proposal preserves existing efficiencies in the clearing and settlement process while providing options for investors to hold securities in their own names and in electronic form. We aim to issue a conclusions paper in the second half of 2019 and expect the regime to be implemented in early 2022.

Enforcement

To protect the interests of the investing public and send strong deterrent messages, we use the full spectrum of sanctions and remedies available to us under the SFO through criminal, administrative, compensatory and disciplinary actions.

We prioritise larger threats and cases which cause serious harm and reputational damage to Hong Kong. Corporate fraud is our top enforcement priority. Our operational divisions collaborate closely to target groups of corporate controllers, managers and financial intermediaries which collude to defraud investors. In some cases, we have conducted large-scale search operations with the assistance of the Independent Commission Against Corruption and the Hong Kong Police. We meticulously examine the evidence seized to lay the foundations for our enforcement actions. We also aim to achieve earlier remedial outcomes to compensate investors harmed by misconduct.

IPO sponsor failures are another focus as sponsors serve an essential gatekeeping role to ensure the quality of our listed companies. We recently disciplined eight sponsor firms and three sponsor principals and imposed record fines. Our enforcement actions send a strong deterrent message to the market.

Our work also focuses on insider dealing, market manipulation and intermediary misconduct, which includes mis-selling of financial products and failure to comply with anti-money laundering requirements.

Green finance

Our *Strategic Framework for Green Finance* sets out a comprehensive strategy to contribute to the development of green finance in Hong Kong, which is particularly well positioned to align with the Mainland's green finance policy and to connect green finance flows between the Mainland and the rest of the world.

[7] In line with the G20 commitments to reform the OTC derivatives market.

As a top priority, we have been working with HKEX to improve listed companies' reporting of environmental information, with an emphasis on climate-related risks and opportunities. The results of a survey of asset managers regarding sustainable investment practices will help us formulate new policies for how environmental and climate-related risks are to be factored into their investment processes and risk assessments.

We are an active participant in international policy-making to pursue sustainable finance, with a specific emphasis on the risks to business arising from the physical effects of climate change and the transition to a less carbon-intensive economy. Most recently, we enhanced our guidance on disclosures by green and environmental, social and governance (ESG) funds in the Hong Kong market. A central database of SFC-authorised green funds will be featured on our website to increase their visibility. We expect that the implications of climate change will very quickly become a mainstream aspect of risk identification and strategic planning for a range of financial and non-financial business and that financial regulations will have an increasing role to play as it becomes clear that the resulting financial risks are of material importance for investors. The SFC intends to be at the forefront of these developments.

Technology

We are in the process of upgrading our infrastructure and security measures to meet rising technology demands. Digitalisation and process automation are key components of our information technology strategy. In January 2019, we launched WINGS[8], an integrated online portal, as the first step to digitalise our submission services and other communications with the industry. The new system also enables efficient processing for faster analysis and review.

Another part of our strategy seeks to leverage technology to strengthen our risk monitoring capabilities. Through our Data Analytics Group, we carry out more effective market surveillance and address risks in a more comprehensive manner whilst our Market Intelligence Programme uses the latest technologies to help us identify patterns of interconnected listed and unlisted companies, individuals and intermediaries which point to potential misconduct. In addition, we are upgrading our systems to allow for more information sharing and collaboration internally.

[8] Web-based INteGrated Service.

Regulatory cooperation

We foster close relationships with our regulatory counterparts in Hong Kong and elsewhere. Locally, we work closely with the Hong Kong Monetary Authority and HKEX on both policy and operational issues. We also take an active role in global initiatives, including through our involvement in international regulatory bodies as well as information sharing and cooperation arrangements.

Our Chief Executive Officer Mr Ashley Alder chairs the Board of the International Organization of Securities Commissions (IOSCO). Its current priority projects include the regulatory response to crypto-asset trading platforms, market fragmentation in wholesale financial markets, online retail distribution of risky products across borders, data privacy, sustainable finance and the impact of index or passive investing, artificial intelligence and machine learning. Mr Alder is also a member of the Financial Stability Board's (FSB) Plenary and Steering Committee. We actively participate in the majority of IOSCO's and the FSB's committees and working groups.

Greater market connectivity with the Mainland and an increasing volume of two-way fund flows means that strong regulatory cooperation with our Mainland counterparts is vital. We maintain regular high-level communications and frequent working-level interactions with the CSRC to discuss cross-boundary regulatory issues and market development projects. We will continue to work closely with the CSRC and other Mainland authorities to expand the Mainland-Hong Kong mutual market access schemes and implement initiatives in the Greater Bay Area.