



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Regulation for Quality Markets

Quarterly Report
April - June 2018

This first Quarterly Report of the Securities and Futures Commission for financial year 2018-19 covers the period from 1 April to 30 June 2018.

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Highlights

Regulatory enhancements

- **Investor compensation:** Our public consultation on the investor compensation regime proposed increasing the compensation limit from \$150,000 to \$500,000 per investor per intermediary default and covering northbound trading under Stock Connect.
- **Discretionary accounts:** We issued consultation conclusions on requirements for intermediaries to provide discretionary account management services to disclose benefits receivable from product issuers and profits earned from trading products with third parties.
- **Over-the-counter (OTC) derivatives:** Together with the Hong Kong Monetary Authority, we concluded a joint consultation on enhancements to the OTC derivatives regime to mandate the use of Legal Entity Identifiers¹. Separately, we launched a consultation on proposed margin requirements for non-centrally cleared OTC derivatives transactions.
- **Professional investors:** Amended rules standardising the prescription of professional investors took effect on 13 July.
- **Takeovers:** After our consultation on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs, the changes came into effect on 13 July.
- **Open-ended fund companies (OFCs):** We published consultation conclusions on the rules and regulations for the new OFC regime which took effect on 30 July.

Corporates

- **Emerging and innovative companies:** Following the SFC's approval, The Stock Exchange of Hong Kong Limited published conclusions to its consultation on proposed new rules to expand the listing regime to facilitate the listing of companies from emerging and innovative sectors which took effect on 30 April.
- **Listing applications:** We reviewed 124 new listing applications, up 69.9% from the previous quarter.

¹ Unique 20-digit, alpha-numeric codes which identify entities in a financial transaction.

Highlights

Intermediaries

- **Licensees and registrants:** As at 30 June, the number of licensees and registrants reached 45,099, up 4.4% year-on-year, and the number of licensed corporations increased 8.9% to 2,775. Both were record highs.
- **Inspections:** We conducted 65 on-site inspections of licensed corporations to review their compliance with regulatory requirements.
- **Alternative liquidity pools (ALPs):** We issued a circular and report highlighting key areas of concern and good practices identified in our thematic review of ALPs.
- **Compliance Forum:** We hosted the SFC Compliance Forum 2018 to exchange views with the industry on current regulatory issues, including IPO² sponsor work and the use of innovative technology to deliver financial services and associated risks.

Markets

- **Stock Connect:** The increase in daily quotas for both the northbound and southbound trading links under Mainland-Hong Kong Stock Connect came into effect on 1 May.

Enforcement

- **Disciplinary actions:** We disciplined five licensed corporations and three representatives, resulting in total fines of \$83.5 million. Citigroup Global Markets Asia Limited was reprimanded and fined \$57 million for failings in its sponsor work on the listing application of Real Gold Mining Limited.
- **Market surveillance:** We made 2,152 requests for trading and account records from intermediaries triggered by untoward price and turnover movements.

Regulatory collaboration

- **IOSCO:** Our Chief Executive Officer, Mr Ashley Alder, was reappointed as Chairman of the Board of the International Organization of Securities Commissions (IOSCO) in May. We became one of the first signatories to the IOSCO Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information for cross-border enforcement cooperation.
- **MoUs:** We entered into a memorandum of understanding (MoU) with the German Federal Financial Supervisory Authority to facilitate cooperation and exchange of information. We also entered into an MoU with the China Banking and Insurance Regulatory Commission to enhance supervisory cooperation.

² Initial public offerings.

Operational Review

Intermediaries

Licence applications

During the quarter, we received 2,030 licence applications, up 2.7% from the last quarter and up 19.6% year-on-year. The number of corporate applications dropped 10.7% from the last quarter to 75, down 6.3% year-on-year.

As at 30 June, the number of licensees and registrants totalled 45,099, up 4.4% from last year, and the number of licensed corporations grew 8.9% to 2,775. Both were record highs.

Securities margin financing

We engaged selected industry representatives to discuss ways to enhance risk management following a study we conducted which showed that brokers' total margin loans had grown nine times between 2006 and 2017 with a significant deterioration in quality. We will share our observations from the study soon.

Professional investors

In May, we issued consultation conclusions on proposals to standardise the rules for prescribing professional investors. The rule amendments aim to ensure consistent application of the regulations and to better serve the interests of both firms and their clients. The amended rules came into effect on 13 July.

Disclosure requirements

We issued consultation conclusions in May to require intermediaries providing discretionary account management services to disclose benefits receivable from product issuers as well as trading profits earned from products purchased from or sold to third parties for their clients. The requirements address potential conflicts of interest arising from incentives provided by product issuers. We also published frequently asked questions (FAQs) to provide further guidance to the industry.

OTC derivatives

We launched a two-month consultation in June on proposals to impose margin requirements for non-centrally cleared over-the-counter (OTC) derivatives transactions. The proposals specify the categories of licensed corporations, counterparties and instruments subject to the requirements for margin exchange, as well as the assets eligible as margin.

Investor compensation regime

Our consultation on proposed enhancements to the investor compensation regime ended in June. The proposals, which included increasing the compensation limit from \$150,000 to \$500,000 per investor per intermediary default and covering northbound trading under Stock Connect, received broad support. We are working with the Government on the necessary legislative amendments and target to issue the consultation conclusions later this year.

Intermediaries

Intermediary monitoring

During the quarter, we conducted 65 on-site inspections of licensed corporations to review their compliance with regulatory requirements.

Promoting compliance

In May, we published the *SFC Compliance Bulletin: Intermediaries* to highlight our concerns in considering licensing applications and to provide an update on the implementation of the Manager-In-Charge regime.

In April, we issued a circular and report to highlight the key areas of concern and good practices identified during our thematic review of alternative liquidity pools (ALPs) and to provide an overview of the ALP landscape in Hong Kong.

The use of instant messaging poses new supervisory and record-keeping challenges. To provide guidance to the industry, we issued a circular in May on the controls and procedures which intermediaries are expected to put in place when receiving clients' orders via instant messaging services.

In a June circular, we reminded intermediaries of their obligation to inform us of any plans to provide trading and asset management services involving crypto-assets or robo-advisory services. Intermediaries were also advised to discuss their plans with the SFC before they engage in these services.

In June, we issued FAQs on the requirements for the disclosure of non-quantifiable monetary benefits and the use of the term "independent" by intermediaries in the sale of investment products. These requirements will come into effect on 17 August.



Anti-money laundering

Following the Government's publication of the *Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report* on 30 April, we issued a circular on the same day to licensed corporations to draw their attention to the results of the assessment and the corresponding mitigating measures they should take. We hosted three seminars in June for about 700 industry participants to discuss the report's key findings and related measures. We also issued another 13 circulars to assist licensed corporations in complying with the requirements during the quarter.

SFC Compliance Forum 2018

The SFC Compliance Forum 2018 was held on 21 June. Over 500 industry participants attended the half-day event to exchange views on the SFC's recent guidance on best execution, client facilitation, IPO¹ sponsors and ALPs. The use of innovative technology to deliver financial services and associated risks were also discussed.

Communication with the industry

In May, we met with eight major broker associations to discuss regulatory updates including the new and proposed guidelines for online distribution and advisory platforms, anti-money laundering and securities margin financing, as well as our recent circular on receiving client orders through instant messaging. We also held briefing sessions for members of four industry associations to explain recent and proposed rule changes.



SFC Compliance Forum 2018

¹ Initial public offerings.

Intermediaries

Licensees and registrants

	As at 30.6.2018	As at 31.3.2018	Change (%)	As at 30.6.2017	YoY change (%)
Licensed corporations	2,775	2,702	2.7	2,549	8.9
Registered institutions	118	120	-1.7	119	-0.8
Licensed individuals	42,206	41,536	1.6	40,536	4.1
Total	45,099	44,358	1.7	43,204	4.4

Licensing applications

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
Applications to conduct new regulated activity	5,894	5,586	5.5	4,810	22.5
Applications for SFC licences [#]	2,030	1,977	2.7	1,698	19.6

[#] Figures do not include applications for provisional licences. During the quarter, we received 1,096 provisional licence applications compared with 847 in the same quarter last year.

Intermediary inspections

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
On-site inspections conducted	65	76	-14.5	74	-12.2

Products

Authorisations

As of 30 June, there were 2,768 SFC-authorised collective investment schemes (CIS) on offer to the public. During the quarter, we authorised 22 CIS, comprising 21 unit trusts and mutual funds and one investment-linked assurance scheme. We also authorised six unlisted structured investment products for public offering.

Mutual recognition of funds

Mainland China

Under the Mainland-Hong Kong mutual recognition of funds (MRF) scheme, as of 30 June, we had authorised a total of 50 Mainland funds (including two umbrella funds), and the China Securities Regulatory Commission had approved 15 Hong Kong funds.

Switzerland

As of 30 June, four SFC-authorised funds were approved by the Swiss Financial Market Supervisory Authority for distribution to retail investors in Switzerland under the Switzerland-Hong Kong MRF arrangement.

Enhanced fund data reporting

On 29 June, we announced enhanced reporting requirements for SFC-authorised funds taking effect from 30 September and covering, amongst other data, funds' asset allocations and securities financing transactions and the liquidity profiles of their assets. This initiative will enhance our supervisory ability.

Online distribution and advisory platforms

In April and May, we held briefings to help the industry better understand and prepare for the implementation of new guidelines for online distribution and advisory platforms which will come into effect in April 2019. Over 200 participants from the asset management, banking, brokerage, financial advisory and financial technology industries attended.



Industry briefing

Open-ended fund companies

On 18 May, we published consultation conclusions 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) regime, which took effect on 30 July. The introduction of this new corporate fund structure broadens the choice of investment fund vehicles and facilitates the distribution of Hong Kong funds internationally.

Authorised collective investment schemes^a

	As at 30.6.2018	As at 31.3.2018	Change (%)	As at 30.6.2017	YoY change (%)
Unit trusts and mutual funds	2,183	2,215	-1.4	2,204	-1
Investment-linked assurance schemes	300	299	0.3	301	-0.3
Pooled retirement funds	34	34	0	34	0
MPF schemes	31	31	0	35	-11.4
MPF pooled investment funds	194	194	0	193	0.5
Others	26 ^b	26	0	26	0
Total	2,768	2,799	-1.1	2,793	-0.9

^a Excluding unlisted structured investment products.

^b Comprising 15 paper gold schemes and 11 real estate investment trusts.

Products

Unlisted structured investment products

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
Unlisted structured investment products ^a	6	9	-33.3	18	-66.7
Authorisations granted under section 105 of the Securities and Futures Ordinance ^b	10	16	-37.5	16	-37.5

^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.

SFC-authorised renminbi investment products

	As at 30.6.2018
Unlisted products	
Unlisted funds primarily investing in the onshore Mainland securities markets ^a or offshore renminbi bonds, fixed income instruments or other securities	74
Other unlisted funds with renminbi share classes ^b	129
Paper gold schemes with renminbi features	1
Recognised Mainland funds under the Mainland-Hong Kong Mutual Recognition of Funds arrangement	50
Unlisted structured investment products with renminbi features ^c	100
Listed products	
Exchange-traded funds (ETFs) primarily investing in the onshore Mainland securities markets ^a or offshore renminbi bonds, fixed income instruments or other securities	34
Other ETFs with renminbi trading counters ^b	20
Renminbi gold ETFs ^d	1
Renminbi real estate investment trusts	1

^a Refers to onshore Mainland investments through the Renminbi Qualified Foreign Institutional Investor (RQFII) quota, Stock Connect, Bond Connect and the China Interbank Bond Market.

^b Refers to unlisted funds or ETFs which have non-renminbi base currency.

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

^d Only includes gold ETF denominated in renminbi.

Corporates

Emerging and innovative companies

Following the SFC's approval, The Stock Exchange of Hong Kong Limited (SEHK) published conclusions to its consultation on the proposed new rules to expand the listing regime to facilitate the listing of companies from emerging and innovative sectors which took effect on 30 April. The Listing Rules now introduce new chapters to allow listings of biotech companies which do not meet existing financial eligibility tests as well as innovative and high growth companies with weighted voting rights (WVR) structures. A new concessionary secondary listing route for Greater China and international innovative companies listed on qualifying exchanges is also provided.

Backdoor listings and shell activities

To maintain the quality and integrity of our markets, we have been working closely with SEHK on a thematic review of listed companies' regulation. The review includes amendments to the Listing Rules and reforms which aim to curb sharp share price movements of GEM stocks on their trading debuts and highly dilutive capital raisings. In June, SEHK published a consultation paper on backdoor listings and continuing listing criteria which will end on 31 August.

Listing applications

Our oversight of listing matters includes vetting of listing applications. During the quarter, we vetted 124 new listing applications, up 69.9% from 73 in the previous quarter and 44.2% from 86 in the same quarter last year. This was another record high. We issued one "letter of mindedness to object" directly to a listing applicant¹.

During the quarter, we received three listing applications from companies with WVR structures and five listing applications from biotech companies.

Corporate conduct

We conduct a daily review of corporate announcements under the statutory corporate conduct and inside information disclosure provisions. During the quarter, we issued section 179² directions to gather additional information in 13 cases and wrote to detail our concerns in 10 transactions. These concerns included, for example, whether a corporate action or transaction had been or is being conducted in a manner which is oppressive or unfairly prejudicial to shareholders.

Listing applications and takeovers activities

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
Listing applications	124	73	69.9	86	44.2
Takeovers and share buy-backs transactions	111	62	79	132	-15.9

¹ The SFC may object to a listing of securities based on one or more of the grounds set out in section 6(2) of the Securities and Futures (Stock Market Listing) Rules. A letter of mindedness to object sets out the SFC's substantive concerns along with detailed reasons.

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

In May, we published the second issue of the *SFC Regulatory Bulletin: Listed Corporations*, which highlighted our early intervention in serious corporate cases including those involving inaccurate or incomplete information in listing applications as well as questionable fundraisings and acquisitions of listed companies.

Takeovers matters

We introduced a new note to section 4.2 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs to align these codes with the new listing regime for companies from emerging and innovative sectors effective from April.

Our three-month consultation on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs ended in April and we issued our

conclusions on 13 July. Respondents were generally supportive of the proposals. Measures introduced to enhance investor protection include empowering the Takeovers Panel³ to require compensation be paid to shareholders who have suffered as a result of a breach of these codes as well as increasing the threshold for independent shareholder approval of a whitewash waiver to 75%.

Other changes include amendments to clarify the power of the Takeover Executive⁴, the Takeovers Panel and the Takeovers Appeal Committee to issue compliance rulings and that persons dealing with them must be open and cooperative. The amendments were gazetted on 13 July and took immediate effect.

³ Hears disciplinary matters in the first instance and reviews rulings by the Takeovers Executive at the request of any party dissatisfied with such a ruling.

⁴ The Takeovers Executive refers to the Executive Director of the Corporate Finance Division of the SFC or his delegate.

Markets

Stock Connect

On 11 April, the SFC and the China Securities Regulatory Commission (CSRC) jointly announced an increase in the daily quotas for Mainland-Hong Kong Stock Connect. The new quotas, RMB52 billion for each of the northbound trading links and RMB42 billion for each of the southbound trading links, took effect on 1 May.

Investor identification

We worked with the CSRC and Hong Kong Exchanges and Clearing Limited (HKEX) on the implementation of an investor identification regime for northbound trading under Stock Connect tentatively scheduled for September following system testing and market rehearsals. A similar regime for southbound trading will be introduced as soon as possible after the regime for northbound trading is implemented.

Supervision of HKEX

In May, we approved proposals from HKEX's clearing houses to enhance the admission criteria and the process for managing the defaults of clearing participants to better align with international practices.

Following our March approval of related rule changes, HKEX implemented measures in June to strengthen clearing guarantee funds, including the introduction of risk-based contributions from the clearing houses.

OTC derivatives

In June, the SFC and the Hong Kong Monetary Authority issued conclusions to their March consultation on enhancements to the over-the-counter (OTC) derivatives regime to mandate the use of Legal Entity Identifiers¹ for the reporting obligation, expand the clearing obligation and adopt a trading determination process for introducing a platform trading obligation.

Market surveillance

In June, we completed a joint project with HKEX to facilitate the monitoring of derivatives trading, which was the second phase of enhancements to our market surveillance system.

To better manage market volatility risk, we automated real-time alerts used for monitoring the impact of stock price fluctuations on the financial soundness of our licensed corporations.

Automated trading services

As of 30 June, the number of automated trading services (ATS)² authorisations under Part III of the Securities and Futures Ordinance (SFO) was 58, while 25 corporations, including 16 dark pool operators, were licensed under Part V of the SFO to provide ATS.

Automated trading services providers

	As at 30.06.2018	As at 31.03.2018	Change (%)	As at 30.06.2017	YoY change (%)
Under Part III	58	57	1.8	50	16
Under Part V	25	24	4.2	24	4.2

¹ Unique 20-digit, alpha-numeric codes which identify entities in a financial transaction.

² Under the SFO, two regimes regulate ATS providers. Typically, those that offer facilities similar to those of a traditional exchange or a clearing house are authorised under Part III of the SFO. Intermediaries which provide dealing services with ATS as an added facility are licensed under Part V of the SFO.

Enforcement

Market Misconduct Tribunal

During the quarter, we commenced proceedings in the Market Misconduct Tribunal (MMT) against the following companies and persons:

- Fujikon Industrial Holdings Limited for failure to disclose inside information as soon as reasonably practicable on the discontinuation of headphone production for a major customer. We also alleged that two directors of Fujikon, Yeung Chi Hung and Chow Lai Fung, were reckless or negligent in causing the alleged breach of the disclosure requirement.
- Magic Holdings International Limited and its nine directors¹ for failure to disclose inside information as soon as reasonably practicable on the potential acquisition of its issued shares by a French cosmetics group in 2013.

We commenced MMT proceedings against Li Kwok Cheong and Li Han Chun, who were respectively former chairman and chief executive officer of China Forestry Holdings Company Limited, for suspected disclosure of false or misleading information inducing transactions in the company's shares. In addition, MMT proceedings were commenced against Li Han Chun and his investment vehicle, Top Wisdom Overseas Holdings Limited, for suspected insider dealing in the shares of China Forestry in 2011. We will seek restoration orders or damages against these individuals and Top Wisdom if the MMT finds them guilty of market misconduct.

Court proceedings

We commenced legal proceedings in the Court of First Instance to seek disqualification orders against three former directors or senior executives² of Far East Holdings International Limited³.

We successfully prosecuted the following in the Eastern Magistrates' Courts:

- Lui Ho Yeung was convicted and fined for making false or misleading representations about his criminal record in his SFC licence application.
- DBA Telecommunication (Asia) Holdings Limited was convicted and fined for making a false or misleading statement in its 2012 results announcement.

Disciplinary actions

We disciplined five licensed corporations and three representatives during the quarter, resulting in total fines⁴ of \$83.5 million.

Sponsor failures

- Citigroup Global Markets Asia Limited was reprimanded and fined \$57 million for failing to conduct adequate and reasonable due diligence on Real Gold Mining Limited's customers and properly supervise its transaction team in relation to Real Gold's listing application.

Internal control failures

- Hang Seng Investment Management Limited was reprimanded and fined \$3 million for deficiencies in its internal controls and procedures relating to the cash management of SFC-authorised funds.
- Noah Holdings (Hong Kong) Limited was reprimanded and fined \$5 million for internal system and control failures in its sale and distribution of investment products.

¹ Stephen Tang Siu Kun, She Yu Yuan, Luo Yao Wen, Cheng Wing Hong, Sun Yan, Chen Dar Cin, Yan Kam Tong, Yang Rude and Dong Yin Mao.

² Duncan Chiu, Derek Chiu and Michael Lui Hung Kwong.

³ The allegations against them include conducting the company's business or affairs in a manner involving defalcation, fraud, misfeasance or misconduct towards the company or its shareholders, or resulting in the shareholders not being given all the information as they might reasonably expect.

⁴ Fines paid by intermediaries in disciplinary actions go into the general revenue of the Government.

Enforcement

- CN Capital Management Limited was reprimanded and fined \$1 million for failing to maintain satisfactory internal controls concerning employee account dealing. Its responsible officers, George Chan Yee Lee and Stephen Ng Wing Leung, were also reprimanded and each fined \$100,000 for failing to comply with the employee account dealing requirements.
- Instinet Pacific Limited was reprimanded and fined \$17.3 million for deficiencies in its internal controls relating to its electronic and algorithmic trading systems and alternative liquidity pool.

Breach of Code of Conduct⁵

Lau Ki Fung, a former account executive of KGI Asia Limited, was reprimanded and fined for failing to keep proper records of client order instructions.

Market surveillance

Our surveillance of untoward price and turnover movements resulted in 2,152 requests for trading and account records from intermediaries during the quarter. In addition, we published two announcements to remind investors to exercise caution when trading shares in companies where a small number of shareholders hold a high concentration of shares.

Enforcement activities

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017
S179 ^a inquiries commenced	5	4	25	9
S181 ^b inquiries commenced (number of letters sent)	75 (2,152)	62 (1,900)	13.3	80 (2,617)
S182 ^c directions issued	60	71	-15.5	90
Investigations started	61	65	-6.2	89
Investigations completed	57	80	-28.8	55
Individuals and corporations charged in criminal proceedings	4	3	33.3	7
Criminal charges laid	37	10	270	14
Notices of Proposed Disciplinary Action ^d issued	2	7	-71.4	7
Notices of Decision ^e issued	12	13	-7.7	9
Individuals and corporations subject to ongoing civil proceedings ^f	110	97	13.4	126
Compliance advice letters issued	49	62	-21	90
Cases with search warrants executed	6	3	100	8

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

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

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

^d 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.

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

^f As of the last day of the reporting period.

⁵ The Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission.

Regulatory engagement

IOSCO

We are actively involved in international policy making. Mr Ashley Alder, our Chief Executive Officer (CEO), was re-appointed as Chairman of the Board of the International Organization of Securities Commissions (IOSCO) at its annual conference in Budapest in May.

The May IOSCO Board meeting, chaired by Mr Alder, focussed on European Union (EU) data privacy regulations, the development of an initial coin offerings support framework, sustainable finance and financial technologies (Fintech) and the use of leverage in asset management.

The SFC became one of the first signatories to the IOSCO Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (EMMoU) for cross-border enforcement cooperation. The EMMoU provides IOSCO members who are signatories with additional tools to combat financial misconduct in the global financial market.

We joined an IOSCO working group to pursue two new projects on the regulation of outsourcing by financial services firms to third party service providers and the use of artificial intelligence by market intermediaries.

Since the EU-Asia Pacific Forum in December 2017, which was co-chaired by Mr Alder in Hong Kong, we have discussed with regulators representing the EU and the IOSCO Asia-Pacific Regional Committee significant cross-border regulatory issues arising from EU regulations which have an impact on Hong Kong and the region. These issues include benchmarks regulation, sustainable finance, Fintech and the cross-border implications of asset management and fund passporting.

Financial Stability Board

Mr Alder attended the Financial Stability Board (FSB) Plenary meeting in June which discussed current financial vulnerabilities, crypto-assets, cyber resilience, developing consistent leverage measures for investment funds and effective disclosure of climate-related financial risks. The Plenary also agreed to invite several new jurisdictions to join the Regional Consultative Groups (RCGs) to ensure effective engagement with non-FSB jurisdictions.

In May, Mr Keith Lui, Executive Director, Supervision of Markets, attended the meeting of the FSB Regional Consultative Group for Asia, which considered vulnerabilities in the global financial system, the resolution of large systemic banks and other financial institutions, the role of Fintech and regulatory technology in addressing money laundering and terrorist financing risks and methods to strengthen governance by holding individuals accountable.

We worked with the Hong Kong Monetary Authority, the Insurance Authority and the Government on the FSB annual monitoring exercise on shadow banking and the annual FSB implementation survey.

Mainland China

In June, we and the China Banking and Insurance Regulatory Commission entered into a Memorandum of Understanding (MoU) to enhance cooperation in the supervision of cross-boundary regulated entities.

In the same month, we and the China Securities Regulatory Commission (CSRC) held our sixth regular high-level meeting to discuss enforcement cooperation matters. We exchanged views on closer

Regulatory engagement

collaboration on market surveillance and sharing of intelligence and market information as well as coordinated investigations. We had in-depth discussions on establishing a notification mechanism for cases involving companies listed in both markets and enhancing staff exchange and joint training arrangements.

During the quarter, we visited the CSRC and the State Administration of Foreign Exchange to discuss cooperation. We also received several high-level Mainland delegations to discuss ongoing cross-boundary cooperation projects.

We organised in-house training programmes for senior executives from various Mainland organisations to enhance mutual understanding and effective communication in cross-boundary regulatory work. We met with the China Financial Futures Exchange, Dalian Commodity Exchange and Shanghai Clearing House to discuss the opening-up of the Mainland futures market and exchange views on renminbi internationalisation and the development of the Mainland's clearing business.

We supported the Government in strengthening Hong Kong's cooperation with different Mainland regions. In May, we attended the Shenzhen-Hong Kong-Macau Joint Conference on Financial Cooperation and Innovation.

Other regulatory engagement

Since joining the United Nations (UN) Sustainable Stock Exchange Initiative's Advisory Group in June, the SFC has been working on how capital market authorities can support the UN's sustainable development goals. The SFC also expressed support for the recommendations of the FSB Task Force on Climate-related Financial Disclosures.¹

In June, we entered into an MoU with the German Federal Financial Supervisory Authority providing for consultation, cooperation and exchange of information in connection with the supervision and oversight of cross-border regulated entities in Hong Kong and Germany. We also entered into a cooperation agreement with the Abu Dhabi Global Market Financial Services Regulatory Authority in the same month to establish a framework for cooperation on Fintech.

¹ See the task force's website (<https://www.fsb-tcfd.org/supporters-landing/>) for details.

Stakeholders

We frequently engage with stakeholders to help them understand the SFC's work and keep them informed about regulatory developments.

Our senior executives spoke at 13 local and international conferences. We held briefing sessions for the industry on the new Guidelines on Online Distribution and Advisory Platforms and key findings of the *Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report*.



Ms Julia Leung, Deputy Chief Executive Officer and Executive Director of Intermediaries, at the SFC Compliance Forum 2018

Our corporate website was enhanced in June to feature a redesigned homepage and make several sections more easily accessible via mobile and tablet devices and by the visually impaired.

We issued the following during the quarter:

- The *Report on the Thematic Review of Alternative Liquidity Pools in Hong Kong*, published in April together with a circular, shared the findings of our thematic review of licensed firms' compliance with the regulatory requirements and examples of good practices.

- The May issue of the *SFC Compliance Bulletin: Intermediaries* discussed our concerns when we consider licensing applications and provided an update on the implementation of the Manager-In-Charge regime.
- The *SFC Regulatory Bulletin: Listed corporations*, published in May, highlighted our early intervention in serious corporate cases which included the provision of inaccurate or incomplete information in listing applications as well as questionable fundraisings and acquisitions of listed companies.
- Our *Annual Report 2017-18*, released in June, summarised the SFC's work during the year and our strategic priorities.

We issued 24 circulars informing industry participants about a wide range of matters, including the use of instant messaging to receive client orders, enhanced fund data reporting and updates on anti-money laundering and counter-terrorist financing.



SFC publications

Stakeholders

Publications and other communications

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Quarter ended 30.6.2017
Press releases	36	34	45
Consultation papers	2	3	4
Consultation conclusions	4	1	2
Industry-related publications	2	3	4
Codes and guidelines ^a	1	2	4
Circulars to industry	24	22	21
Corporate website average daily page views ^b	67,880	67,172	68,825
General enquiries	1,828	2,140	1,722

^a Includes updates to previous versions.

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

Corporate Developments

Board

In July, the Financial Secretary appointed Mr James C Lin as Non-Executive Director (NED) for a two-year term effective 1 August. Dr William Wong Ming-fung, SC was reappointed as NED for two years effective on the same date. Ms Teresa Ko Yuk-yin stepped down as an NED at the end of her six-year term.

Also in the same month, Mr Brian Ho and Mr Keith Lui were reappointed as Executive Directors for three years and one year respectively, effective 28 August.

Regulatory committees

New appointments and reappointments to the following committees¹ took effect from 1 April:

- Academic and Accreditation Advisory Committee
- Committee on Real Estate Investment Trusts
- Disciplinary Chair Committee
- Investor Compensation Fund Committee
- Nominations Committee
- Products Advisory Committee
- Public Shareholders Group
- Securities Compensation Fund Committee
- SFC (HKEC Listing) Committee
- Takeovers and Mergers Panel
- Takeovers Appeal Committee

Full membership lists, with titles and affiliations, and details of the responsibilities of each committee are available on the SFC website (www.sfc.hk).

Finance

Our income for the quarter was \$441 million, 25% lower than the previous quarter but 4% higher than the same quarter last year. Average daily turnover in Hong Kong's securities market was \$110 billion, 27% lower than the \$151 billion recorded in the previous quarter. Our expenditure for the quarter was \$434 million, 6% lower than last quarter and 2% higher year-on-year. We recorded a surplus of \$7 million this quarter. After setting aside \$3 billion for the possible future acquisition of office premises, our reserves stood at \$4.2 billion as of 30 June.

Staffing

As of 30 June, we had 887 staff members, up from 869 a year ago.

¹ Each of these committees is set up under the Securities and Futures Ordinance and specialises in particular regulatory areas.

Corporate Developments

Finances

(\$ million)	Quarter ended 30.06.2018	Quarter ended 31.03.2018	Quarter ended 30.06.2017	YoY change (%)
Income	441	586	426	4
Expenses including depreciation	434	462	424	2
Surplus	7	124	2	250

Activity Data

Table 1 Breaches noted during on-site inspections

Nature of breaches	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
Failure to comply with Securities and Futures (Financial Resources) Rules	4	4	0	5	-20
Failure to safekeep client securities	14	4	250	10	40
Failure to maintain proper books and records	8	7	14.3	8	0
Failure to safekeep client money	9	13	-30.8	15	-40
Unlicensed dealing and other registration issues	5	8	-37.5	3	66.7
Breach of licensing conditions	0	1	-100	2	-100
Breach of requirements of contract notes/ statements of account/receipts	12	15	-20	19	-36.8
Failure to make filing/notification	0	1	-100	1	-100
Breach of margin requirements	4	1	300	2	100
Marketing malpractices	0	0	0	0	0
Illegal short selling of securities	0	0	0	0	0
Dealing malpractices	1	1	0	0	N/A
Breach of Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ¹	115	70	64.3	86	33.7
Breach of Corporate Finance Adviser Code of Conduct	0	3	-100	3	-100
Breach of Fund Manager Code of Conduct	9	20	-55	23	-60.9
Breach of regulation of on-line trading	1	0	N/A	3	-66.7
Non-compliance with anti-money laundering guidelines	33	47	-29.8	37	-10.8
Breach of other rules and regulations of the Exchanges ²	7	8	-12.5	4	75
Breach of other rules and regulations of the Mandatory Provident Fund Schemes Authority	0	0	0	0	0
Internal control weaknesses ³	127	161	-21.1	132	-3.8
Others	19	18	5.6	18	5.6
Total	368	382	-3.7	371	-0.8

¹ Commonly related to risk management, record keeping, client agreements, safeguarding of client assets and management responsibilities.

² The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited.

³ 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.

Table 2 Authorised unit trusts and mutual funds – by type

	As at 30.6.2018	As at 31.3.2018	Change (%)	As at 30.6.2017	YoY change (%)
Bond	446	449	-0.7	431	3.5
Equity	1,002	1,030	-2.7	1,017	-1.5
Diversified	174	172	1.2	164	6.1
Money market	45	45	0	44	2.3
Fund of funds	113	116	-2.6	113	0
Index ¹	160	157	1.9	181	-11.6
Guaranteed	3	3	0	4	-25
Hedge	0	1	-100	2	-100
Other specialised ²	5	5	0	7	-28.6
Sub-total	1,948	1,978	-1.5	1,963	-0.8
Umbrella structures	235	237	-0.8	241	-2.5
Total	2,183	2,215	-1.4	2,204	-1

¹ Including leveraged and inverse products.

² Including futures and options funds, structured funds and funds which invest in financial derivative instruments.

Table 3 Authorised unit trusts and mutual funds – by type and assets under management

	Total NAV (US\$ million) as at 30.6.2018	Total NAV (US\$ million) as at 31.3.2018	Change (%)	Total NAV (US\$ million) as at 30.6.2017	YoY change in total NAV (%)
Bond	517,696	569,700	-9.1	512,653 ¹	1
Equity	737,678	787,889	-6.4	684,944	7.7
Diversified	179,493	180,353	-0.5	148,550	20.8
Money market	20,357	20,905	-2.6	20,802	-2.1
Fund of funds	22,522	22,897	-1.6	21,272	5.9
Index ²	93,861	97,637	-3.9	96,531	-2.8
Guaranteed	95	105	-9.5	134	-29.1
Hedge	0	26	-100	27	-100
Other specialised ³	999	1,061	-5.8	1,170	-14.6
Total	1,572,701	1,680,573	-6.4	1,486,083¹	5.8

¹ These figures differ from those disclosed in the Quarterly Report Apr - Jun 2017 due to a revised figure reported after the report's issuance.

² Including leveraged and inverse products.

³ Including futures and options funds, structured funds and funds which invest in financial derivative instruments.

Table 4 Authorised unit trusts and mutual funds – by origin

	As at 30.6.2018	As at 31.3.2018	Change (%)	As at 30.6.2017	YoY change (%)
Hong Kong	765	758	0.9	745	2.7
Luxembourg	1,028	1,041	-1.2	1,019	0.9
Ireland	233	239	-2.5	252	-7.5
United Kingdom	54	69	-21.7	63	-14.3
Mainland China	50	50	0	49	2
Other Europe	3	3	0	3	0
Bermuda	1	1	0	5	-80
Cayman Islands	41	46	-10.9	60	-31.7
Others	8	8	0	8	0
Total	2,183	2,215	-1.4	2,204	-1

Table 5 Authorised unit trusts and mutual funds – by origin and assets under management

	Total NAV (US\$ million) as at 30.6.2018	Total NAV (US\$ million) as at 31.3.2018	Change (%)	Total NAV (US\$ million) as at 30.6.2017	YoY change in total NAV (%)
Hong Kong	151,987	158,199	-3.9	140,451	8.2
Luxembourg	1,062,352	1,105,904	-3.9	980,207	8.4
Ireland	210,085	232,586	-9.7	194,827 ¹	7.8
United Kingdom	80,166	109,340	-26.7	98,379	-18.5
Mainland China	18,262	20,855	-12.4	18,187	0.4
Other Europe	131	137	-4.4	108	21.3
Bermuda	167	173	-3.5	204	-18.1
Cayman Islands	8,779	9,033	-2.8	11,184	-21.5
Others	40,771	44,346	-8.1	42,538	-4.2
Total	1,572,701²	1,680,573	-6.4	1,486,083^{1, 2}	5.8

¹ These figures differ from those disclosed in the Quarterly Report Apr - Jun 2017 due to a revised figure reported after the report's issuance.

² The figure does not add up to total due to rounding.

Table 6 Takeovers activities

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
Codes on Takeovers and Mergers and Share Buy-backs					
General and partial offers under Code on Takeovers and Mergers	18	10	80	21	-14.3
Privatisations	1	1	0	4	-75
Whitewash waiver applications	8	6	33.3	11	-27.3
Other applications under Code on Takeovers and Mergers ¹	77	45	71.1	96	-19.8
Off-market and general offer share buy-backs	4	0	N/A	0	N/A
Other applications under Code on Share Buy-backs ¹	3	0	N/A	0	N/A
Total	111	62	79	132	-15.9
Executive Statements					
Sanctions imposed with parties' agreement ²	1	1	0	0	N/A
Takeovers and Mergers Panel					
Meetings for review of Codes on Takeovers and Mergers and Share Buy-backs	1	0	N/A	0	N/A
Hearings before the Panel (disciplinary and non-disciplinary)	0	0	0	1	-100
Statements issued by the Panel ³	0	0	0	1	-100

¹ Including stand-alone applications and those made during the course of a code-related transaction.

² Pursuant to section 12.3 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs.

³ Pursuant to section 16.1 of the Introduction to the Codes on Takeovers and Mergers and Share Buy-backs.

Table 7 Complaints against intermediaries and market activities

	Quarter ended 30.6.2018	Quarter ended 31.3.2018	Change (%)	Quarter ended 30.6.2017	YoY change (%)
Conduct of licensees	121	109	11	74	63.5
Conduct of registered institutions	3	5	-40	6	-50
Listed companies and disclosure of interests	258	186	38.7	204	26.5
Market misconduct ¹	97	95	2.1	53	83
Product disclosure	2	5	-60	1	100
Unlicensed activities	57	39	46.2	27	111.1
Breach of offers of investments	9	5	80	17	-47.1
Boiler rooms and suspicious websites	95	88	8	86	10.5
Scams and frauds ²	74	75	-1.3	45	64.4
Other financial activities ³	138	243	-43.2	67	106
Total	854	850	0.5	580	47.2

¹ Primarily, alleged market manipulation and insider dealing.

² Such as identity fraud and impersonation.

³ For example, bullion trading, banking services.

Securities and Futures Commission

Condensed consolidated statement of profit or loss and other comprehensive income

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Unaudited quarter ended 30 June 2018 \$'000	Unaudited quarter ended 30 June 2017 \$'000
Income		
Levies	391,558	272,269
Fees and charges	29,994	40,854
Investment income	19,734	99,728
Less : custody and advisory expenses	(1,996)	(1,824)
Investment income net of third party expenses	17,738	97,904
Recoveries from the Investor Compensation Fund	1,484	1,450
Other income	131	13,139
	440,905	425,616
Expenses		
Staff costs and directors' emoluments	330,855	317,023
Premises		
Rent	50,171	52,630
Rates, management fees and others	11,450	12,700
Other expenses	33,226	34,391
Depreciation	7,865	6,938
	433,567	423,682
Surplus and total comprehensive income for the quarter	7,338	1,934

The notes on pages 30 to 32 form part of the condensed consolidated financial statements.

Condensed consolidated statement of financial position

At 30 June 2018 (Expressed in Hong Kong dollars)

	Note	Unaudited at 30 June 2018 \$'000	Audited at 31 March 2018 \$'000
Non-current assets			
Fixed assets		73,657	71,923
Financial assets at amortised cost		1,446,879	–
Held-to-maturity debt securities		–	1,546,613
		1,540,536	1,618,536
Current assets			
Financial assets at amortised cost		114,225	–
Held-to-maturity debt securities		–	35,503
Financial assets at fair value through profit or loss			
Debt securities		775,018	772,300
Pooled funds		924,898	934,768
Debtors, deposits and prepayments		213,624	219,778
Fixed deposits with banks	3	3,753,413	3,713,477
Cash at bank and in hand	3	44,831	33,353
		5,826,009	5,709,179
Current liabilities			
Fees received in advance		8,214	8,810
Creditors and accrued charges		144,092	113,317
		152,306	122,127
Net current assets		5,673,703	5,587,052
Total assets less current liabilities		7,214,239	7,205,588
Non-current liabilities	4	42,137	40,824
Net assets		7,172,102	7,164,764
Funding and reserves			
Initial funding by Government		42,840	42,840
Reserve for property acquisition		3,000,000	3,000,000
Accumulated surplus		4,129,262	4,121,924
		7,172,102	7,164,764

The notes on pages 30 to 32 form part of the condensed consolidated financial statements.

Condensed statement of financial position

At 30 June 2018 (Expressed in Hong Kong dollars)

	Note	Unaudited at 30 June 2018 \$'000	Audited at 31 March 2018 \$'000
Non-current assets			
Fixed assets		73,622	71,859
Financial assets at amortised cost		1,466,879	–
Held-to-maturity debt securities		–	1,546,613
		1,540,501	1,618,472
Current assets			
Financial assets at amortised cost		114,225	–
Held-to-maturity debt securities		–	35,503
Financial assets at fair value through profit or loss			
Debt securities		775,018	772,300
Pooled funds		924,898	934,768
Debtors, deposits and prepayments		219,566	221,338
Fixed deposits with banks		3,753,413	3,713,477
Cash at bank and in hand		31,662	21,171
		5,818,782	5,698,557
Current liabilities			
Fees received in advance		8,214	8,810
Creditors and accrued charges		136,830	102,631
		145,044	111,441
Net current assets		5,673,738	5,587,116
Total assets less current liabilities		7,214,239	7,205,588
Non-current liabilities	4	42,137	40,824
Net assets		7,172,102	7,164,764
Funding and reserves			
Initial funding by Government		42,840	42,840
Reserve for property acquisition		3,000,000	3,000,000
Accumulated surplus		4,129,262	4,121,924
		7,172,102	7,164,764

The notes on pages 30 to 32 form part of the condensed consolidated financial statements.

Condensed consolidated statement of changes in equity

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Initial funding by Government \$'000	Reserve for property acquisition \$'000	Accumulated surplus \$'000	Total \$'000
Balance at 1 April 2017	42,840	3,000,000	3,879,060	6,921,900
Surplus and total comprehensive income for the quarter	–	–	1,934	1,934
Balance at 30 June 2017	42,840	3,000,000	3,880,994	6,923,834
Balance at 1 April 2018	42,840	3,000,000	4,121,924	7,164,764
Surplus and total comprehensive income for the quarter	–	–	7,338	7,338
Balance at 30 June 2018	42,840	3,000,000	4,129,262	7,172,102

The notes on pages 30 to 32 form part of the condensed consolidated financial statements.

Condensed consolidated statement of cash flows

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Note	Unaudited quarter ended 30 June 2018 \$'000	Unaudited quarter ended 30 June 2017 \$'000
Cash flows from operating activities			
Surplus and total comprehensive income for the quarter		7,338	1,934
Adjustments for :			
Depreciation		7,865	6,938
Investment income		(19,734)	(99,728)
Exchange difference		1,614	(7,793)
		(2,917)	(98,649)
Decrease/(increase) in debtors, deposits and prepayments		3,879	(16,990)
Increase in creditors and accrued charges		30,775	12,404
Decrease in fees received in advance		(596)	(686)
Increase in non-current liabilities		1,313	3,400
Net cash generated from/(used in) operating activities		32,454	(100,521)
Cash flows from investing activities			
Decrease in fixed deposits other than cash and cash equivalents		596,622	54,835
Interest received		31,748	19,950
Debt securities at fair value through profit or loss purchased		(81,019)	(159,335)
Debt securities at fair value through profit or loss sold or redeemed		76,680	125,684
Pooled funds sold		1,150	818
Fixed assets purchased		(9,599)	(6,132)
Net cash generated from investing activities		615,582	35,820
Net increase/(decrease) in cash and cash equivalents		648,036	(64,701)
Cash and cash equivalents at beginning of the quarter		292,105	676,727
Cash and cash equivalents at end of the quarter	3	940,141	612,026

Analysis of the balance of cash and cash equivalents

	Unaudited at 30 June 2018 \$'000	Unaudited at 30 June 2017 \$'000
Fixed deposits with banks	895,310	573,421
Cash at bank and in hand	44,831	38,605
	940,141	612,026

The notes on pages 30 to 32 form part of the condensed consolidated financial statements.

Notes to the condensed consolidated financial statements

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

1. Basis of preparation

We have prepared the condensed consolidated interim financial information in accordance with Hong Kong Accounting Standard (HKAS) 34, *Interim financial reporting* adopted by the Hong Kong Institute of Certified Public Accountants (HKICPA).

This condensed consolidated interim financial information contains condensed consolidated financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Securities and Futures Commission (SFC) since the annual financial statements for the year ended 31 March 2018. The condensed consolidated interim financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with Hong Kong Financial Reporting Standards.

The condensed consolidated interim financial information is unaudited and the financial information relating to the financial year ended 31 March 2018 included in this report does not constitute the SFC's statutory annual financial statements for that financial year but is derived from those financial statements.

We consolidated the financial results of the Investor Compensation Company Limited (ICC) and Investor Education Centre (IEC) in the SFC's condensed financial statements made up to 30 June 2018. We eliminated all material intragroup balances and transactions in preparing the condensed consolidated financial statements. We have applied the same accounting policies adopted in the consolidated financial statements for the year ended 31 March 2018 to the condensed consolidated interim financial information except for the adoption of Hong Kong Financial Reporting Standard (HKFRS) 9, *Financial instruments* and HKFRS 15, *Revenue from contracts with customers* as issued by the HKICPA, both with a date of transition of 1 January 2018. The adoption of HKFRS 15 did not have any impact on the Group's accounting policies and did not require retrospective adjustments. The impact of the adoption of HKFRS 9 is disclosed in note 2 below.

There were no significant changes in the operations of the SFC for the quarter ended 30 June 2018.

2. Changes in accounting policies

Impact on the condensed consolidated interim financial information

HKFRS 9 replaces the provisions of HKAS 39, *Financial instruments: Recognition and measurement* that relate to the recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets.

The adoption of HKFRS 9 resulted in changes in accounting policies and potential adjustments to the amounts recognised in the financial statements. In accordance with the transitional provisions in HKFRS 9, comparative figures need not be restated.

Debt securities that would have previously been classified as held-to-maturity are now classified as financial assets at amortised cost. We intended to hold the debt securities to maturity to collect contractual cash flows which consist solely of payments of principal and interest on the principal amount outstanding. There was no impact on the amounts recognised in relation to these assets from the adoption of HKFRS 9.

Debt securities carried at amortised cost are subject to HKFRS 9's new expected credit loss model. All the debt securities are considered to have low credit risk as they are rated A or above. The loss allowance as a result of applying the expected credit loss model was immaterial.

As part of the transition to HKFRS 9, financial assets that we managed on a fair value basis had previously been designated at fair value through profit or loss under HKAS 39, are now required to be classified as fair value through profit or loss. Other financial assets that were measured at amortised cost (e.g. fixed deposits with banks) previously will continue with their classification and measurement. There was no impact on the amounts recognized in relation to these assets from the adoption of HKFRS 9.

3. Cash and cash equivalents

Reconciliation with the condensed consolidated statement of financial position

	Unaudited at 30 June 2018 \$'000	Audited at 31 March 2018 \$'000
Cash at bank and in hand	44,831	33,353
Fixed deposits with banks	3,753,413	3,713,477
Amounts shown in the condensed consolidated statement of financial position	3,798,244	3,746,830
Less : Amounts with an original maturity of beyond three months	(2,858,103)	(3,454,725)
Cash and cash equivalents in the condensed consolidated statement of cash flows	940,141	292,105

4. Non-current liabilities

Non-current liabilities represent provision for premises reinstatement cost to restore the premises to its original condition when the lease has expired.

5. Ageing analysis of debtors and creditors

There was no material overdue debtor balance and creditor balance included in "debtors, deposits and prepayments" and "creditors and accrued charges" respectively as at 30 June 2018. Therefore we do not provide an ageing analysis of debtors and creditors.

6. Exchange fluctuation

The SFC's investment guidelines for our investment portfolio only allow investments in assets denominated in Hong Kong dollars, US dollars and renminbi. Exposure in renminbi should not exceed 5% of the investment portfolio. As the majority of the financial assets are denominated in either US dollars or Hong Kong dollars which are closely pegged, we do not consider we are exposed to significant foreign exchange risk.

7. Investments in subsidiaries

The SFC formed ICC on 11 September 2002 with an issued share capital of \$0.2. On 20 November 2012, the SFC launched IEC as a company limited by guarantee and not having a share capital. Both companies are wholly-owned subsidiaries of the SFC and are incorporated in Hong Kong.

The objective of ICC is to facilitate the administration and management of the Investor Compensation Fund (ICF) established under the Securities and Futures Ordinance (SFO).

The objective of IEC is to improve the financial knowledge and capability of the general public and to assist them in making informed financial decisions.

As at 30 June 2018, the investments in subsidiaries, which are stated at cost less any impairment losses, amounted to \$0.2 (at 31 March 2018: \$0.2). The balance is too small to appear on the statement of financial position which is expressed in thousands of dollars.

The financial statements of ICC and IEC are included in the condensed consolidated financial statements.

8. Related party transactions

We have related party relationships with the ICF, the Unified Exchange Compensation Fund, the Securities Ordinance (Chapter 333) - Dealers' Deposits Fund, the Commodities Trading Ordinance (Chapter 250) - Dealers' Deposits Fund and the Securities Ordinance (Chapter 333) - Securities Margin Financiers' Security Fund. In addition to the transactions and balances disclosed elsewhere in these financial statements, the group entered into the following material related party transactions:

- (a) During the quarter, we received reimbursement from the ICF for all ICC's expenses amounting to \$1,484,000 (2017: \$1,450,000), in accordance with section 242(1) of the SFO. As at 30 June 2018, the amount due to the ICF from ICC was \$612,000 (at 31 March 2018: \$203,000).
- (b) Remuneration of key management personnel comprised:

	Unaudited quarter ended	
	30 Jun 2018 \$'000	30 Jun 2017 \$'000
Directors' fees and salaries, allowances and benefits in kind	8,307	8,060
Retirement scheme contributions	761	736
	9,068	8,796

The total remuneration is included in "staff costs and directors' emoluments" on page 25. Discretionary pay is not included above as the decision to pay is subject to the approval process towards the end of the financial year and therefore is not determined until then.

9. Commitment to pay rents for offices

As at 30 June 2018, the minimum amount we are committed to pay in rent for our offices up to 31 August 2020 are as follows:

	Unaudited at 30 Jun 2018 \$'000	Audited at 31 Mar 2018 \$'000
Payable next year	200,296	200,457
Payable in one to five years	233,940	284,069
Payable in more than five years	–	–
	434,236	484,526

During the quarter, \$50,171,000 net of lease incentives, was recognised as an expense in the condensed consolidated statement of profit or loss and other comprehensive income in respect of operating leases (2017: \$52,630,000).

Investor Compensation Fund

Report of the Investor Compensation Fund Committee

The members of the Investor Compensation Fund Committee (the Committee) present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2018.

Establishment of the Investor Compensation Fund

Part XII of the Securities and Futures Ordinance (Chapter 571) established the Investor Compensation Fund (the Fund) on 1 April 2003.

Financial statements

The financial performance of the Fund for the reporting period ended 30 June 2018 and the financial position of the Fund as at that date are set out in the unaudited condensed financial statements on pages 34 to 39.

Members of the Committee

The members of the Committee during the quarter ended 30 June 2018 and up to the date of this report were:

Mr Keith Lui	(Chairman)
Ms Teresa Ko Yuk-yin, JP	(retired on 31 July 2018)
Mr Lee Kwok Keung	
Mr Thomas Allen Atkinson	
Dr William Wong Ming Fung, SC	(appointed on 1 August 2018)

Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member of the Fund had a material interest, subsisted at the end of the reporting period or at any time during the quarter.

On behalf of the Committee

Keith Lui
Chairman

14 August 2018

Condensed statement of profit or loss and other comprehensive income

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Note	Unaudited quarter ended 30 June 2018 \$'000	Unaudited quarter ended 30 June 2017 \$'000
Income			
Net investment (loss)/income		(6,028)	30,226
Exchange difference		(1,267)	7,503
		(7,295)	37,729
Expenses			
Investor Compensation Company Limited expenses	3	1,484	1,450
Auditor's remuneration		51	49
Bank charges		230	236
Professional fees		1,064	1,044
		2,829	2,779
(Deficit)/surplus and total comprehensive income for the quarter		(10,124)	34,950

The notes on pages 38 and 39 form part of the condensed financial statements.

Investor Compensation Fund

Condensed statement of financial position

At 30 June 2018 (Expressed in Hong Kong dollars)

	Unaudited at 30 June 2018 \$'000	Audited at 31 March 2018 \$'000
Current assets		
Financial assets at fair value through profit or loss		
Debt securities	1,941,410	1,939,279
Pooled fund	–	350,084
Interest receivable	17,073	17,015
Amount due from Investor Compensation Company Limited	612	203
Fixed deposits with banks	15,042	52,586
Cash at bank	378,332	3,347
	2,352,469	2,362,514
Current liabilities		
Creditors and accrued charges	1,443	1,364
	1,443	1,364
Net current assets	2,351,026	2,361,150
Net assets	2,351,026	2,361,150
Representing :		
Compensation fund		
Contributions from Unified Exchange Compensation Fund	994,718	994,718
Contributions from Commodity Exchange Compensation Fund	108,923	108,923
Accumulated surplus	1,247,385	1,257,509
	2,351,026	2,361,150

The notes on pages 38 and 39 form part of the condensed financial statements.

Investor Compensation Fund

Condensed statement of changes in equity

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Contributions from Unified Exchange Compensation Fund \$'000	Contributions from Commodity Exchange Compensation Fund \$'000	Accumulated surplus \$'000	Total \$'000
Balance at 1 April 2017	994,718	108,923	1,176,765	2,280,406
Surplus and total comprehensive income for the quarter	–	–	34,950	34,950
Balance at 30 June 2017	994,718	108,923	1,211,715	2,315,356
Balance at 1 April 2018	994,718	108,923	1,257,509	2,361,150
Deficit and total comprehensive income for the quarter	–	–	(10,124)	(10,124)
Balance at 30 June 2018	994,718	108,923	1,247,385	2,351,026

The notes on pages 38 and 39 form part of the condensed financial statements.

Condensed statement of cash flows

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Unaudited quarter ended 30 June 2018 \$'000	Unaudited quarter ended 30 June 2017 \$'000
Cash flows from operating activities		
(Deficit)/surplus for the quarter	(10,124)	34,950
Adjustments for:		
Net investment loss/(income)	6,028	(30,226)
Exchange difference	1,267	(7,503)
	(2,829)	(2,779)
Increase in amount due from Investor Compensation Company Limited	(409)	(441)
Decrease in provision for compensation	–	(150)
Increase in creditors and accrued charges	79	127
Net cash used in operating activities	(3,159)	(3,243)
Cash flows from investing activities		
Debt securities purchased	(145,306)	(255,998)
Debt securities sold or redeemed	132,602	273,651
Pooled fund sold	338,934	399
Interest received	14,370	11,923
Net cash generated from investing activities	340,600	29,975
Net increase in cash and cash equivalents	337,441	26,732
Cash and cash equivalents at beginning of the quarter	55,933	44,971
Cash and cash equivalents at end of the quarter	393,374	71,703

Analysis of the balance of cash and cash equivalents

	Unaudited at 30 June 2018 \$'000	Unaudited at 30 June 2017 \$'000
Fixed deposits with banks	15,042	70,298
Cash at bank	378,332	1,405
	393,374	71,703

The notes on pages 38 and 39 form part of the condensed financial statements.

Notes to the condensed financial statements

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

1. Basis of preparation

The Fund has prepared the condensed interim financial information in accordance with Hong Kong Accounting Standard (HKAS) 34, *Interim financial reporting* adopted by the Hong Kong Institute of Certified Public Accountants (HKICPA).

The condensed interim financial information contains condensed financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Fund since the annual financial statements for the year ended 31 March 2018. The condensed interim financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with Hong Kong Financial Reporting Standards.

The condensed interim financial information is unaudited and the financial information relating to the financial year ended 31 March 2018 included in this report does not constitute the Fund's statutory annual financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2018 to this condensed interim financial information except for the adoption of Hong Kong Financial Reporting Standard (HKFRS) 9, *Financial instruments* as issued by the HKICPA, with a date of transition of 1 January 2018. The impact of the adoption of HKFRS 9 is disclosed in note 2 below.

There were no significant changes in the operations of the Fund for the quarter ended 30 June 2018.

2. Changes in accounting policies

Impact on the condensed interim financial information

HKFRS 9 replaces the provisions of HKAS 39, *Financial instruments: Recognition and measurement* that relate to the recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets.

The adoption of HKFRS 9 resulted in changes in accounting policies and potential adjustments to the amounts recognised in the financial statements. In accordance with the transitional provisions in HKFRS 9, comparative figures need not be restated.

As part of the transition to HKFRS 9, financial assets that we managed on a fair value basis had previously been designated at fair value through profit or loss under HKAS 39, are now required to be classified as fair value through profit or loss. Other financial assets that were measured at amortised cost (e.g. fixed deposits with banks) previously will continue with their classification and measurement.

There was no impact on the amounts recognised in relation to these assets from the adoption of HKFRS 9.

3. Investor Compensation Company Limited expenses

The SFC formed the Investor Compensation Company Limited (ICC) in September 2002 to perform functions on behalf of the Fund in relation to the compensation to investors and other functions under Part III and Part XII of the Securities and Futures Ordinance. The Fund is responsible for funding the establishment and operation of the ICC. For the quarter ended 30 June 2018, the ICC incurred \$1,484,000 for its operation (for the quarter ended 30 June 2017: \$1,450,000).

4. Material related party transactions

We have related party relationships with the Securities and Futures Commission, ICC and the Unified Exchange Compensation Fund. There were no significant related party transactions other than those disclosed in the condensed interim financial information of the Fund for the quarters ended 30 June 2017 and 2018.

5. Contingent liabilities

As at the date of this report, there are 10 claims received for which currently there is insufficient information to determine the likely level of payment. The maximum liability of these claims is \$1,611,000 (at 31 March 2018: \$2,375,000). This is determined based on the lower of the maximum compensation limit of \$150,000 per claimant or the amount claimed.

Unified Exchange Compensation Fund

Report of the Securities Compensation Fund Committee

The members of the Securities Compensation Fund Committee (the Committee) present their quarterly report and the unaudited condensed financial statements for the quarter ended 30 June 2018.

Establishment of the Unified Exchange Compensation Fund

Part X of the repealed Securities Ordinance (Chapter 333) established the Unified Exchange Compensation Fund (the Fund). However, when the Securities and Futures Ordinance (SFO) and its subsidiary legislation came into effect on 1 April 2003, a new single Investor Compensation Fund (ICF) was formed to ultimately replace the Fund and the Commodity Exchange Compensation Fund. Up to 30 June 2018, the Fund has transferred \$994,718,000 to the ICF. After settlement of all claims against the Fund and its other liabilities, the Securities and Futures Commission will eventually transfer the remaining balance of the Fund to the ICF.

Part X of the repealed Securities Ordinance remains effective in respect of the operation of the Fund to the extent described in Section 74 of Schedule 10 of the SFO.

Financial statements

The financial performance of the Fund for the reporting period ended 30 June 2018 and the financial position of the Fund as at that date are set out in the unaudited condensed financial statements on pages 41 to 46.

Members of the Committee

The members of the Committee during the quarter ended 30 June 2018 and up to the date of this report were:

Mr Keith Lui	(Chairman)
Ms Mak Po Shuen	
Ms Teresa Ko Yuk-yin, JP	(retired on 31 July 2018)
Mr Lee Kwok Keung	
Mr Thomas Allan Atkinson	
Dr William Wong Ming Fung, SC	(appointed on 1 August 2018)

Interests in contracts

No contract of significance to which the Fund was a party and in which a Committee member of the Fund had a material interest, subsisted at the end of the reporting period or at any time during the quarter.

On behalf of the Committee

Keith Lui

Chairman

6 August 2018

Unified Exchange Compensation Fund

Condensed statement of profit or loss and other comprehensive income

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Unaudited quarter ended 30 June 2018 \$'000	Unaudited quarter ended 30 June 2017 \$'000
Income		
Interest income	271	160
Expenses		
Auditor's remuneration	25	24
Surplus and total comprehensive income for the quarter	246	136

Highlights

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The notes on pages 45 and 46 form part of the condensed financial statements

Unified Exchange Compensation Fund

Condensed statement of financial position

At 30 June 2018 (Expressed in Hong Kong dollars)

	Note	Unaudited at 30 June 2018 \$'000	Audited at 31 March 2018 \$'000
Current assets			
Equity securities received under subrogation		1	1
Interest receivable		130	98
Accounts receivable		9	9
Fixed deposits with banks		87,132	86,525
Cash at bank		206	224
		87,478	86,857
Current liabilities			
Creditors and accrued charges		10,328	10,303
Relinquished trading rights payable to SEHK	4	750	750
		11,078	11,053
Net current assets		76,400	75,804
Net assets		76,400	75,804
Representing:			
Compensation fund		76,400	75,804

The notes on pages 45 and 46 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Condensed statement of changes in equity

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Trading rights deposits from SEHK (see note 4) \$'000	Excess transaction levy from SEHK \$'000	Additional contributions from SEHK and the SFC \$'000	Other contributions \$'000	Accumulated surplus \$'000	Contributions to Investor Compensation Fund \$'000	Total \$'000
Balance at 1 April 2017	51,200	353,787	630,000	6,502	26,120	(994,718)	72,891
Net contributions from SEHK	550	–	–	–	–	–	550
Surplus and total comprehensive income for the quarter	–	–	–	–	136	–	136
Balance at 30 June 2017	51,750	353,787	630,000	6,502	26,256	(994,718)	73,577
Balance at 1 April 2018	53,500	353,787	630,000	6,502	26,733	(994,718)	75,804
Net contributions from SEHK	350	–	–	–	–	–	350
Surplus and total comprehensive income for the quarter	–	–	–	–	246	–	246
Balance at 30 June 2018	53,850	353,787	630,000	6,502	26,979	(994,718)	76,400

The notes on pages 45 and 46 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Condensed statement of cash flows

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

	Unaudited quarter ended 30 June 2018 \$'000	Unaudited quarter ended 30 June 2017 \$'000
Cash flows from operating activities		
Surplus for the quarter	246	136
Adjustment for:		
Interest income	(271)	(160)
	(25)	(24)
Increase in accounts receivable	–	(10)
Increase/(decrease) in creditors and accrued charges	25	(72)
Increase in relinquished trading rights payable to SEHK	–	200
Net cash generated from operating activities	–	94
Cash flows from investing activities		
Interest received	239	171
Net cash generated from investing activities	239	171
Cash flows from financing activities		
Net trading rights deposits from SEHK	350	550
Net cash generated from financing activities	350	550
Net increase in cash and cash equivalents	589	815
Cash and cash equivalents at beginning of the quarter	86,749	84,076
Cash and cash equivalents at end of the quarter	87,338	84,891

Analysis of the balance of cash and cash equivalents

	Unaudited at 30 June 2018 \$'000	Unaudited at 30 June 2017 \$'000
Fixed deposits with banks	87,132	84,341
Cash at bank	206	550
	87,338	84,891

The notes on pages 45 and 46 form part of the condensed financial statements.

Notes to the condensed financial statements

For the quarter ended 30 June 2018 (Expressed in Hong Kong dollars)

1. Basis of preparation

The Fund has prepared the condensed interim financial information in accordance with Hong Kong Accounting Standard (HKAS) 34, *Interim financial reporting* adopted by the Hong Kong Institute of Certified Public Accountants (HKICPA). As the Fund will eventually cease operation as a result of the Securities and Futures Ordinance which came into effect from 1 April 2003, the Fund has prepared the condensed interim financial information on a non-going concern basis. We expect that the operations of the Fund will be maintained until all claims and recoveries from liquidators in relation to the broker defaults that happened on or before 31 March 2003 have been fully settled.

This condensed interim financial information contains condensed financial statements and selected explanatory notes. The notes include an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the Fund since the annual financial statements for the year ended 31 March 2018. The condensed interim financial statements and notes thereon do not include all of the information required for full set of financial statements prepared in accordance with Hong Kong Financial Reporting Standards.

The condensed interim financial information is unaudited and the financial information relating to the financial year ended 31 March 2018 included in this report does not constitute the Fund's statutory annual financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2018 to this condensed interim financial information except for the adoption of Hong Kong Financial Reporting Standard (HKFRS) 9, *Financial instruments* as issued by the HKICPA, with a date of transition of 1 January 2018. The impact of the adoption of HKFRS 9 is disclosed in note 2 below.

There were no significant changes in the operations of the Fund for the quarter ended 30 June 2018.

2. Changes in accounting policies

Impact on the condensed interim financial information

HKFRS 9 replaces the provisions of HKAS 39, *Financial instruments: Recognition and measurement* that relate to the recognition, classification and measurement of financial assets and financial liabilities and impairment of financial assets.

The adoption of HKFRS 9 resulted in changes in accounting policies and potential adjustments to the amounts recognised in the financial statements. In accordance with the transitional provisions in HKFRS 9, comparative figures need not be restated.

Financial assets that were measured at amortised cost (e.g. fixed deposits with banks) previously will continue with their classification and measurement with the adoption of HKFRS 9. There was no impact on the amounts recognised in relation to these assets from the adoption of HKFRS 9.

3. Equity securities received under subrogation

In relation to the share distribution from C.A. Pacific Securities Ltd. and C.A. Pacific Finance Ltd., the liquidators had advised the Securities and Futures Commission (SFC) that shares were allocated to the Fund under its subrogation rights, subject to paying a processing fee to the liquidators. The Fund recognised as recoveries the payments from liquidators, the sale proceeds of shares allocated and the remaining shares at market value as of 30 June 2018 after deducting relevant processing fees and charges for collecting and selling the shares received.

The shares allocated to the Fund under its subrogation rights are classified as financial assets at fair value through profit or loss in accordance with HKFRS 9. According to HKFRS 13, *Fair value measurement*, these subrogated shares shall be classified as level 1 financial instruments as they all have quoted market price (unadjusted) in an active market for an identical instrument. At the end of each reporting period the fair value is remeasured, with any resultant gain or loss being recognised in "Recoveries". Dividend income, if any, is also recognised in Recoveries.

4. Trading rights deposits from SEHK/Relinquished trading rights payable to SEHK

According to Section 104 of the repealed Securities Ordinance, The Stock Exchange of Hong Kong Limited (SEHK) contributes to the Fund in respect of each trading right at the rate of \$50,000 per trading right. In the absence of claims or other provisions as set out in Section 106 of the repealed Securities Ordinance., the SFC must refund to SEHK the deposit within six months after the trading right was relinquished.

During the quarter, deposits of \$450,000 in respect of nine new trading rights were received from SEHK and deposits of \$100,000 in respect of two relinquished trading rights were refunded to SEHK.

At 30 June 2018, there were 15 trading rights in total of \$750,000 that have been relinquished but not yet refunded (at 31 March 2018: 15). The net contributions from SEHK at 30 June 2018, excluding the relinquished trading rights payable, amounted to \$53,850,000 (at 31 March 2018: \$53,500,000).

5. Material related party transactions

The Fund has related party relationships with the Investor Compensation Fund and the SFC. There were no significant related party transactions other than those disclosed in the condensed interim financial information of the Fund for the quarters ended 30 June 2018 and 2017.

6. Contingent liabilities

As at the date of this report, there is no outstanding claim against the Fund.

In relation to the default cases, any excess of recovered amounts (refer to note 3) will be re-distributed to claimants. As the timing of any future re-distribution and amount of these potential excess amounts are uncertain at the date of this report, we disclose this as a contingent liability.

Securities and Futures Commission

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