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## INDUSTRY OVERVIEW

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### OVERVIEW OF THE HONG KONG SECURITIES MARKET

#### History of the Hong Kong securities market

Formed by the unification of the Hong Kong Stock Exchange, the Far East Exchange Limited, the Kam Ngan Stock Exchange Limited and the Kowloon Stock Exchange Limited, the Stock Exchange of Hong Kong Limited was officially opened on 2 April 1986. Following the market crash in October 1987, the SFC was established to provide investors with a stable, orderly and fair market through regulation in 1989. The central clearing system and the automated order matching and execution system were introduced in 1992 and 1993 respectively so as to improve the trading facilities in the Hong Kong securities market. On 6 March 2000, the Hong Kong Exchanges and Clearing Limited was formed by the merger of the Stock Exchange, the Futures Exchange and the HKSCC under a single holding company. Its shares were listed by way of introduction on the Stock Exchange on 27 June 2000 and it became one of the world’s first listed stock exchanges.

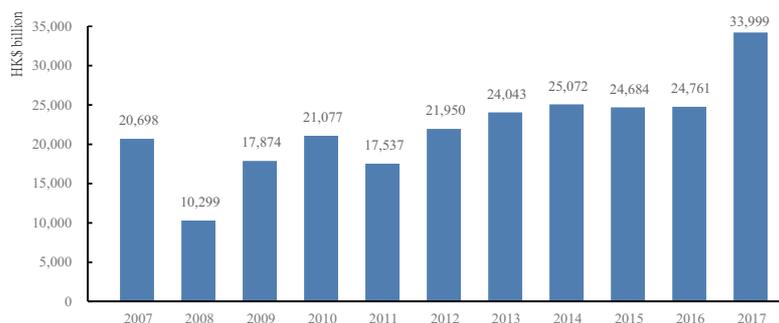
As the first stage of the mutual market access with other markets in the world, the Shanghai Connect was officially launched on 17 November 2014. On 21 October 2015, Hong Kong Futures Exchange Limited, HKFE Clearing Corporation Limited, the London Metal Exchange (“LME”) and the London Metal Exchange Clearing House (“LME Clear”) signed a memorandum of cooperation, with an aim to establish a trading connection between HKFE and LME and a settlement connection between HKFE Clearing Corporation and LME Clear (collectively referred to as “London-Hong Kong Connect”). On 5 December 2016, the Shenzhen Connect was launched to further promote two-way access to capital market after the Shanghai Connect. On 3 July 2017, the Bond Connect was officially launched to bring a major breakthrough for the bond market development in the PRC.

#### Total market capitalisation and the number of Hong Kong listed companies

As at 31 December 2017, the total market capitalisation of Hong Kong listed companies (including Main Board and GEM) was HK\$33,998.8 billion. The total market capitalisation of Hong Kong listed companies rose from HK\$20,697.5 billion in 2007 to HK\$33,998.8 billion in 2017, representing a CAGR of 5.1% over the last decade. According to the World Federation of Exchanges and SFC, the HKEx had a market capitalisation of USD4,350.5 billion as at 31 December 2017 and ranked seventh among the world’s top Stock Exchanges.

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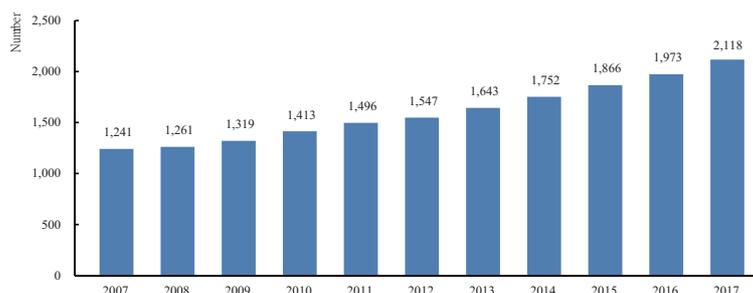
### Total market capitalisation of Hong Kong listed companies from 2007 to 2017



Source: HKEx Fact Book (2007-2017)

As at 31 December 2017, the number of Hong Kong listed companies (including the Main Board and GEM) was 2,118. The number of Hong Kong listed companies increased from 1,241 in 2007 to 2,118 in 2017, representing a CAGR of 5.5% over the last decade.

### Number of listed companies on the Main Board and GEM from 2007 to 2017

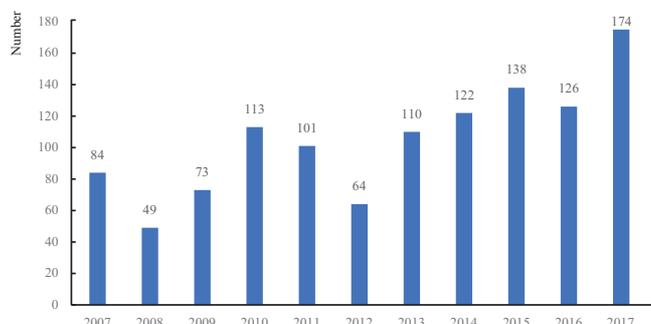


Source: HKEx Fact Book (2007-2017)

## IPO

Since 2013, the number of IPOs on the Stock Exchange of Hong Kong has consistently been over 100 per annum, reflecting the attractiveness of Hong Kong as an international financial hub. Hong Kong ranked fourth in the world's IPO markets in terms of funds raised (on a provisional basis) from January 2017 to November 2017.

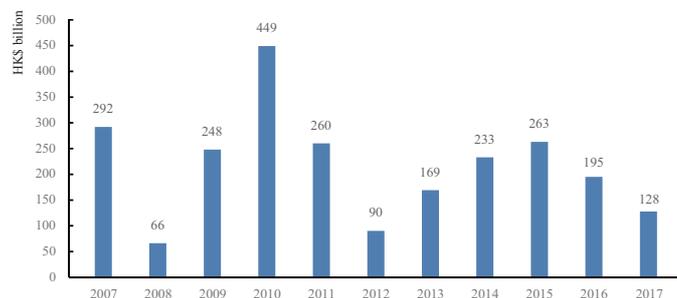
### Number of IPOs in Hong Kong from 2007 to 2017



Source: HKEx Fact Book (2007-2017), including transfer of listing from GEM to Main Board

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### Total funds raised through IPO in Hong Kong from 2007 to 2017

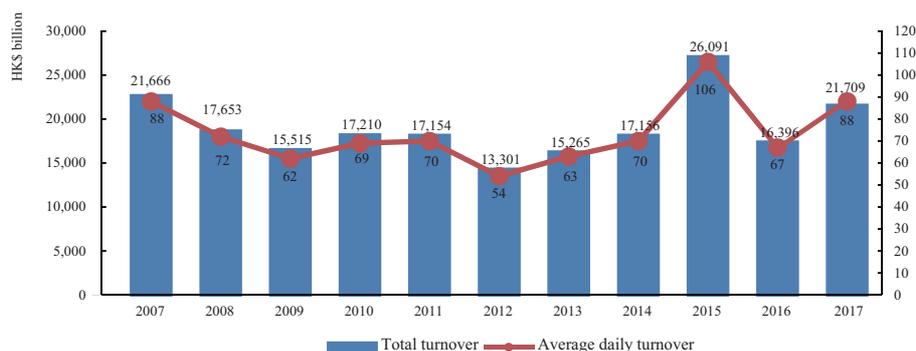


Source: HKEx Fact Book (2007-2017)

### Secondary market

Affected by the adverse impact of the global financial tsunami that broke out in 2008, the turnover of Hong Kong securities market dropped significantly from HK\$21,666 billion in 2007 to HK\$15,515 billion in 2009. The turnover of Hong Kong securities market gradually recovered in the next two years until the European debt crisis aggravated by the end of 2011, which led to a weak securities market in 2012. Total turnover for 2012 was HK\$13,301 billion, representing a decrease of 22.5% from HK\$17,154 billion in 2011. Following the introduction of the Shanghai Connect on 17 November 2014, the turnover of the Hong Kong stock market topped at HK\$26,091 billion in 2015 and dropped sharply to HK\$16,396 billion in 2016 due to the downward adjustment of the China A-Share index in mid-2015. Benefitting from the launch of the Shenzhen Connect, China’s economy recovery and bullish market sentiment, the Hang Seng Index has experienced a 11-month surge and the total turnover reached HK\$21,709 billion in the year ended 31 December 2017.

### Total turnover and average daily turnover from 2007 to 2017 of Hong Kong Securities Market



Source: HKEx Fact Book (2007-2017)

### Exchange participants

To trade securities through the trading facilities of HKEx, participants must (among others) hold the Stock Exchange Trading Rights and should also be licensed corporations which can carry on Type 1 (dealing in securities) regulated activity under the SFO. They should also comply with the financial resources rules stipulated by the Financial Resources Rules (amendments) and HKEx.

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As at 31 December 2017, 669 Stock Exchange Trading Rights holders were registered with HKEx, including 622 trading Exchange Participants, 32 non-trading-Stock Exchange Participants and 15 non-Stock Exchange Participants. As at 31 December 2016, 608 Stock Exchange Trading Rights holders were registered with HKEx, including 556 trading Exchange Participants, 36 non-trading-Stock Exchange Participants and 16 non-Stock Exchange Participants.

Market participants are divided into 3 categories based on market share by the Stock Exchange:

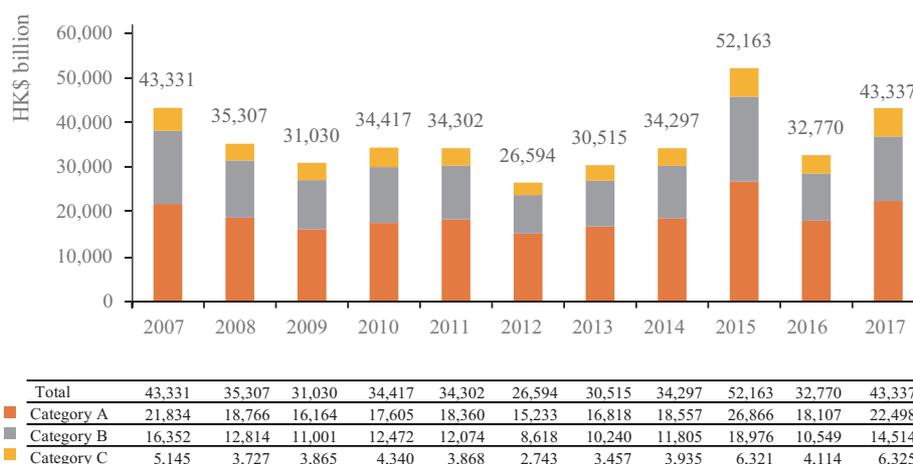
- (a) Category A (brokerage firms ranking 1st to 14th, by proportion to total turnover);
- (b) Category B (brokerage firms ranking 15th to 65th, by proportion to total turnover); and
- (c) Category C (brokerage firms ranking after 65th, by proportion to total turnover).

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### HONG KONG SECURITIES BROKERAGE INDUSTRY

#### Securities brokerage business

**Transaction value by category of Stock Exchange Participants, 2007-2017**



*Note:* Both buy and sell transactions have been counted in the calculation. The range of transaction size is of exclusive at the bottom end and inclusive at the top end, e.g. 50,000 — 100,000 should read as >50,000 and <=100,000.

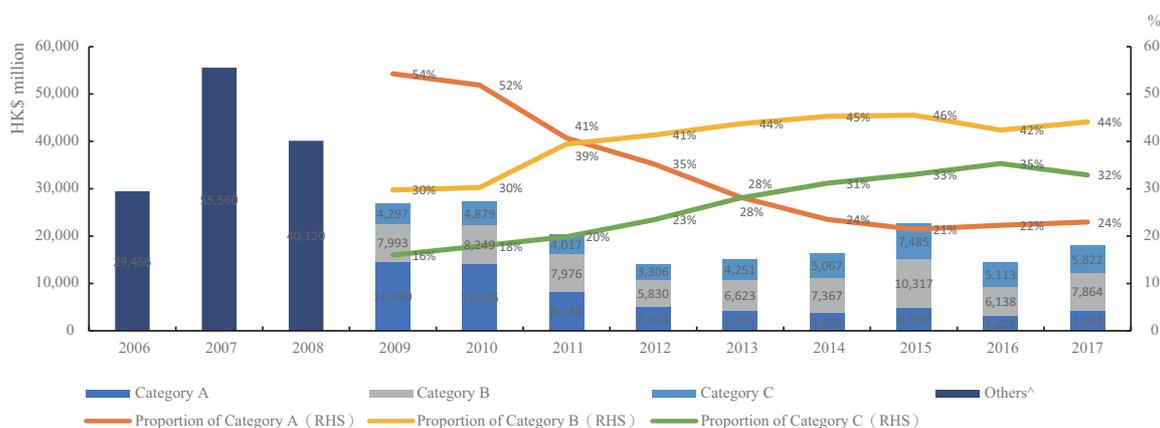
*Source:* SFC

Category B exhibits a stronger growth of transaction value than the other two categories in market boom time. The total transaction value recorded a dramatical rise of about 158.6% in one year to HK\$43,331 billion in 2007, of which Category B demonstrated the most significant growth of 174.3%, followed by Category A with 150.4% and Category C with 148.2%. The total transaction value was then cooled down to HK\$35,307 billion in 2008, where the transaction values of Category A, Category B and Category C decreased by 14.1%, 21.6% and 27.6% when comparing to 2007. There was also a remarkable increase in total transaction value from HK\$34,297 billion in 2014 to HK\$52,163 billion in 2015, where Category B reached the highest growth of 60.7% comparing to Category A and Category C which were 44.8% and 60.6% respectively. The total transaction value was then dropped to HK\$32,770 billion in 2016, of which Category B reflected a notable decrease of

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44.4% with reference to 2015, whereas the drop of Category A and Category C were 32.6% and 34.9% respectively. For the year ended 31 December 2017, each of categories A, B and C accounted for 51.9%, 33.5% and 14.6% of the market share in terms of transaction value.

### Net securities commission income - by category



^ Net securities commission income from SEHK participants (net securities commission income from SEHK participants from 2006 to 2008 were not classified by category)

Source: Financial review of the securities industry for the year ended 31 December 2006-2017

Over the last decade, the net securities commission income from SEHK participants topped at HK\$55,560 million in 2007 and recovered to approximately HK\$22,661 million in 2015 due to the introduction of Shanghai Connect and bullish market sentiment. Although the transaction value hit a new high in 2015, the net securities commission income from SEHK participants was significantly lower than that in 2007. During 2009 to 2015, the proportion of net securities commission income from categories A decreased from 54% to 21% while the proportion of net securities commission income from categories B and C increased from 30% and 16% to 46% and 33% respectively. The net securities commission income from SEHK participants dropped significantly to HK\$14,476 million in 2016 due to the correction of the China A-Share index in mid-2015. For the year ended 31 December 2017, the net securities commission income from SEHK participants was HK\$17,935 million and the proportion of net securities commission income from categories A, B and C remained stable.

### Securities margin business

In January 2007, the Hong Kong Monetary Authority (“HKMA”) issued guidelines on “New Share Subscription and Share Margin Financing”, which stipulated that authorised lending institutions should impose reasonable margin requirements on loans to individual clients. At present, the market generally collects a margin of 10.0% on lending. The authorised lending institutions should act prudently when determining margin rates and consider the relevant financial capacity, liquidity and price volatility of individual securities. The prevailing market standards are: (i) 50.0% to 60.0% for blue-chip securities (some authorised lending institutions adopt 70.0%); and (ii) 30.0% to 40.0% for second and third tier securities.

According to the annual reports of the SFC (2014-2015, 2015-2016 and 2016-2017), margin business developed rapidly and the number of active margin clients increasing from 139,375 in 2012 to 267,132 in 2016, representing a CAGR of 17.7%. The amounts receivable from active margin clients has grown from HK\$58.8 billion in 2012 to HK\$171.6 billion in 2016, representing a CAGR of 30.7% and the average collateral coverage fluctuated between 3.9 and 4.4 times.

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### Number of active margin clients and amounts receivable from margin clients from 2012 to 2016



	As at 31 December				
	2012	2013	2014	2015	2016
Average collateral coverage <i>(Note)</i>	4.2x	3.9x	4.2x	4.4x	4.0x

Source: Annual reports of SFC (2014-15, 2015-16, 2016-17)

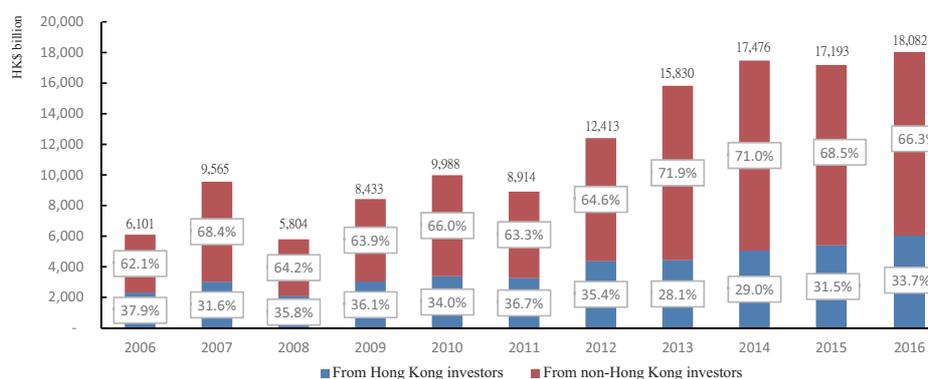
Note: Average collateral coverage represents the number of times the aggregate market value of securities collateral deposited by margin clients over the amounts receivable from these clients on a given date on an industry-wide basis.

### Asset management business

According to Fund Management Activities Survey 2016 released by the SFC, the scale of, combined fund management business (excluding REITs) in Hong Kong increased from HK\$6,101 billion in 2006 to HK\$18,082 billion in 2016, of which asset management business, private banking business of registered institutions and fund advisory business of licenced corporations accounted for 70.9%, 22.4% and 6.6% respectively.

Overseas investors remained the main source of funding for Hong Kong’s fund management business, accounting for 66.3% (excluding REITs) of the market in 2016. Benefiting from the gradual liberalisation of the PRC financial market, stable overseas funds flow into the Hong Kong market help consolidate the status of Hong Kong as an international financial centre.

### Fund management business (excluding REITs) — by source of funds



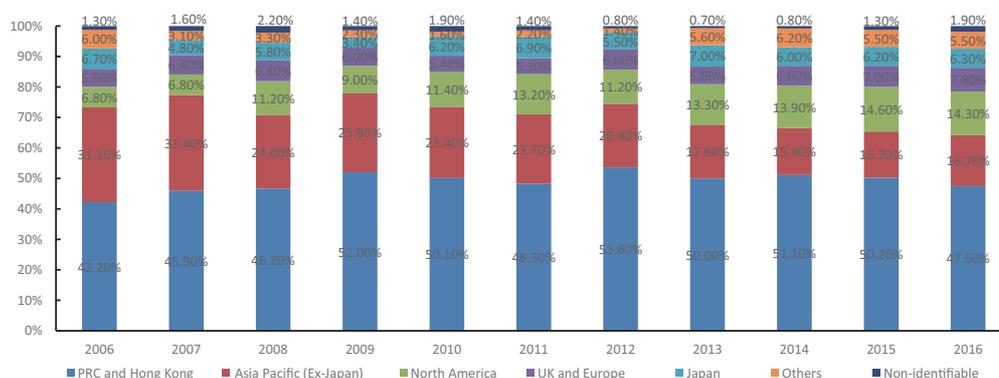
Source: SFC’s Fund Management Activities Survey (2006-2016)

As a result of Hong Kong’s solid infrastructure and talent pool, the proportion of assets managed in Hong Kong remained stably over the past three years and reached 54.8% of the asset management business in 2016.

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Out of the assets managed in Hong Kong in 2016, 54.3% were invested in equities while 26.8% were invested in bonds. In 2016, the PRC and Hong Kong remained the most preferred locations for investment, which amounted to \$3,337 billion and accounted for 47.5% of all assets managed in Hong Kong.

**Assets managed in Hong Kong (by geographical distribution)**



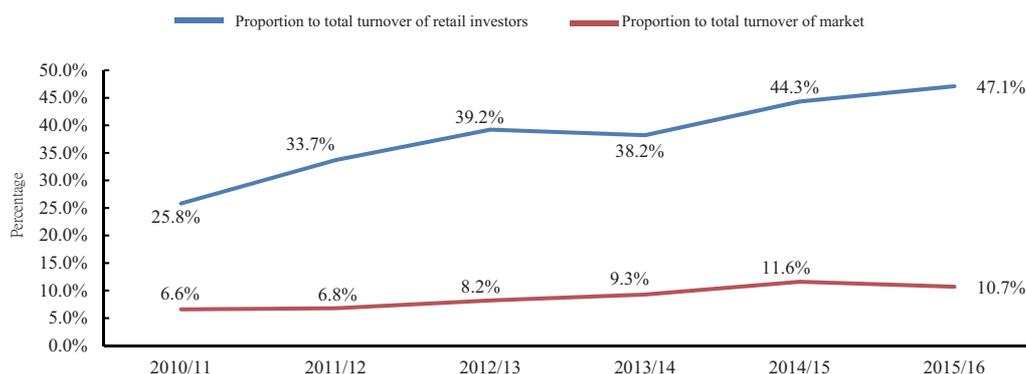
Source: SFC’s Fund Management Activities Survey (2006-2016)

## FUTURE OUTLOOK

### Online brokerage business

According to the Cash Market Transaction Survey released by HKEx in July 2017, the number of online brokers increased from 209 in 2010/11 (response rate: 48%) to 274 in 2016 (response rate: 61%), representing a growth of 31.1%. Percentage of online trading to retail investors’ trading increased from 25.8% in 2010/11 to 47.1% in 2016.

**Proportion of retail online trading to cash market transaction (2010/11-2016)**



Source: HKEx - Cash Market Transaction Survey (2010/11 — 2016)

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### Cash market transaction survey (2010/11-2016)

	2010/11	2011/12	2012/13	2013/14	2014/15	2016
Number of respondents	431	453	457	433	414	446
Online brokers						
Number of online brokers	209	245	250	247	240	274
- Response rate	48%	54%	55%	57%	58%	61%
Online trading						
Estimated total turnover (HK\$ million)	1,252,109	919,187	1,235,360	1,465,223	3,079,997	1,758,013
- Proportion to total turnover of retail investors	25.8%	33.7%	39.2%	38.2%	44.3%	47.1%
- Proportion to total turnover of market	6.6%	6.8%	8.2%	9.3%	11.6%	10.7%

Source: HKEx — Cash Market Transaction Survey (2010/11 — 2016)

### Advanced trading system

To meet the needs that all transactions must be carried on in the trading hall at that time, HKEx launched the AMS terminal in 1993. As the relevant technology became obsolete, HKEx replaced the AMS terminal with New Securities Trading Device (“NSTD”). The new securities trading facility is offered to all exchange participants under the brand name “ET Trade Speed Station”. ET Trade Speed Station is a front-end trading facility, which is compatible with new main market platforms of HKEx: HKEx Orion Central Gateway (“OCG”) and HKEx Orion Market Data Platform - Securities Market (“OMD-C”).

### One Belt One Road Initiative

One Belt One Road Initiative is one of the important strategies for national development of the PRC, and Hong Kong has been playing an important role as an investment and financing centre. Participants can use this platform to finance and carry out One Belt One Road Initiative related business through public offerings, bond issues and syndicated loans as well as other diversified channels. The HKMA launched the Infrastructure Financing Facilitation Office (“IFFO”) in July 2016, which has been a partner with more than 60 professional organisations since then.

### Internationalisation of RMB

With the implementation of the strategy, the PRC has signed RMB swap agreements with various countries along the route, and some of these countries were granted the quotas of RMB Qualified Foreign Institutional Investors (“RQFII”) by the State Administration of Foreign Exchange of the PRC (中華人民共和國國家外匯管理局). Trade settlement, direct investment and financing for projects, currency swap and offshore RMB market establishment ushered in tremendous opportunities. As one of the world’s largest offshore RMB pools of funds, Hong Kong will play an important role in the internationalisation of RMB.

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### Investment globalisation of PRC investors

Along with the introduction of the Shanghai Connect, and the Shenzhen Connect, the efforts in investment and currency globalisation have been stepped up. As an international financial hub and offshore Renminbi centre backed by mature financial and transparent legal systems, Hong Kong capital market will continue to be benefited by the influx of larger amount of capitals from the PRC. The proliferation and increasing internationalisation of the PRC stock market have also been attracting increasing attention and investment from overseas investors into the PRC. Meanwhile, due to the continuous adjustment of deposit interest rate, PRC investors will tend to seek investment opportunities with higher returns, and therefore the demand for investment in capital markets from PRC investors is expected to increase in the future, which will also drive the growth of Hong Kong capital market serving as a bridge between the PRC and overseas markets.

### Competitive landscape

The rapid development of the Hong Kong stock market created demand for the securities industry, but at the same time intensified the competition among the small and medium-sized securities firms. On 1 April 2003, the minimum commission requirement was abolished by the HKEx. Brokerage firms may determine their own commissions with their clients, which exacerbates the competition in Hong Kong’s securities brokerage business. As at 31 December 2017, 669 Stock Exchange Trading Rights holders were registered with HKEx, including 622 trading Stock Exchange Participants, 32 non-trading Stock Exchange Participants and 15 non-Stock Exchange Participants.

Year	Category A (Ranking 1-14)	Category B (Ranking 15-65)	Category C (Ranking after 65)
2013	55.97%	32.54%	11.49%
2014	54.24%	34.15%	11.61%
2015	52.31%	35.30%	12.39%
2016	56.55%	32.94%	10.51%
2017	54.64%	34.88%	10.48%

Source: HKEx Fact Book 2017

Note: The above report includes all Stock Exchange Participant companies that have paid the transaction levy, investor compensation levy (if applicable) and transaction fees to the Stock Exchange.

As stated in the above table, the market share of the Hong Kong securities brokerage business in terms of market turnover was relatively concentrated. The top 14 participants accounted for 54.64% of the market share and the market share of Category B participants increased to 34.88% in 2017.

By the end of 2017, the number of corporations licensed by the SFC for asset management (type 9 regulated activity) in Hong Kong increased by 13.6% to 1,477 corporations comparing to the previous year. The number of individuals licensed for asset management also grew correspondingly by 10.3% to 10,530. In addition, PRC companies continued to actively expand in the Hong Kong market. As at 31 March 2017, the number of licensed corporations and registered institutions established by PRC-related groups in Hong Kong increased by 15.9% year-on-year and reached 313.

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### ENTRY BARRIERS TO THE HONG KONG CAPITAL MARKET AND CHALLENGES

The main entry barriers into the Hong Kong securities market include the following:

#### **Regulatory requirements**

The SFC is responsible for regulating the securities and futures markets in Hong Kong. Securities trading activities are regulated by the SFO and relevant laws. A new participant must be licensed by the SFC to become a licensed corporation. A licensed corporation shall have no less than two Responsible Officers who should directly supervise the conduct of regulated activities. Among those Responsible Officers to be appointed, at least one of them must be an executive director defined by the SFO. Therefore, the cost for new entrants to enter the Hong Kong securities brokerage industry is high.

#### **Fierce competition**

Along with the continuous development of the Hong Kong capital market and connections with the PRC market, various types of companies, including international large-scale investment banks, PRC-funded securities groups, and local securities companies, are competing intensively for larger market share. Leading players in the industry usually have years of experience, pool of talents, sound reputation, large client base and network accumulation in the market, with mature business models and operational processes. Compared with large-scale leading players, new entrants may face the risk and challenge of limited and inadequate resources in terms of pricing, project scale and turnover, client base, talent and capital.

#### **Requirement to comply with the FRR**

The FRR applies to licensed corporations conducting one or more type of regulated activity. They are designed to address risks arising from various aspects of the regulated activities carried out by licensed corporations and aim to ensure that licensed corporations have sufficient liquid assets to meet ongoing liabilities as they fall due. Licensed corporations are required to comply with the capital requirements of the FRR in order to become and remain licensed by the SFC. As a safeguard against non-compliance, licensed corporations are required to periodically report their financial positions to the SFC. New entrants and existing licensed corporations will face challenges from meeting the requirements regulated by the FRR.