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## 1. BROKERS

- A broker is defined as a firm that acts as an intermediary between a buyer and a seller of securities
- Brokers charge a commission for their services and may provide advice to investors

### 1.1 Role and Duties

- All Hong Kong brokers must be licensed by the SFC
- Brokers who trade securities on the SEHK must be EPs. There were 655 EPs at 31 August 2019
- A client may hold a discretionary and/or a non-discretionary account with a broker
  - **Discretionary account:** the client allows the broker full and unfettered discretion to trade for a designated account or parameters are set within which the broker can act
  - **Non-discretionary account:** broker can only act under specific instructions from the client

### 1.2 Licensing

- Any entity involved in the following activities must be licensed by the SFC
  - Dealing in securities
  - Trading in futures contracts
  - Giving investment advice on securities or futures contracts
  - Providing margin financing for the trading of securities on a stock exchange
  - Providing credit rating services
  - Trading in leveraged foreign exchange contracts
- Authorized Financial Institutions, which are supervised and regulated by the HKMA, must be registered with the SFC if they wish to conduct an SFC regulated activity
- To obtain an SFC license, a broker must be considered “fit and proper” in terms of financial standing, reputation and competence

### 1.3 Responsibilities

- Brokers have the following responsibilities, as per SFC regulations, to protect the interests of investors:
  - **Client agreement:** a broker must enter into a written agreement with the client (in Chinese or English) before providing any services
  - **Know your client rule:** a broker must establish the identity of the client and retain a copy of the identity document. The broker should gain sufficient understanding of the client’s financial situation, investment experience and investment objectives, thereby enabling appropriate advice and recommendations to be given
  - **Provision of information to clients:** a broker must issue a contract note to a client for each securities transaction and provide monthly statements. Details of all fees charged should be disclosed

- **Authority to pledge securities:** a broker can only pledge a client's securities if a written authority from the client has been received
  - **Segregation of clients' assets:** all client money and client securities should be kept separate from the broker's own assets and held in client or trust accounts
  - **Adequate internal control procedures:** brokers must maintain adequate internal control procedures to ensure the integrity, efficiency and security of their operations
  - **Regulatory supervision:** a broker must comply with all applicable regulatory requirements and agree to have regular supervisory inspections
  - **Compensation arrangements:** an EP must join and contribute to the Investor Compensation Fund
- The above must be fulfilled by a broker in all client dealings
  - Broker recommendations should be matched to the client's particular needs, objectives and circumstances

## 2. TRADERS

- An individual or organization that acts as a principal rather than an agent in securities transactions
- May hold an inventory of securities for sale at a profit
- An individual employed as a "trader" by an investment or securities firm may perform a number of roles, including:
  - **Flow traders:** usually assume risk by holding positions (long or short) in securities or derivatives **to assist with large orders from institutional clients**. Revenue is generated from the spread between the bid and the ask. Trades may be on exchange or OTC. Also known as **market makers** or **block traders**
  - **Proprietary traders:** often known as prop traders, they take on positions for their own and their employer's account **to make money from market movements**. Prop traders normally take a longer term view than flow traders
- Depending upon the firm, the same person may act as both a flow trader and a prop trader
- Traders can be categorized by the products traded such as stock traders, futures traders, plain vanilla traders and exotic traders
- Traders, as with brokers, are required to be licensed with the SFC, however pure prop traders may be exempt from the requirement

## 3. RESEARCH ANALYSTS

- They study companies by reviewing historical and current information and can work for investment banks, brokerage houses, fund houses etc.
- **Fundamental analysts** use information to forecast the performance of a company
- **Technical analysts** use charts and historical data to predict a company's share price movement

- **Analyst reports** are often used by brokers and traders to provide investment advice to their clients and can have a significant effect on market prices
- Some analysts focus on particular companies or industry sectors, while others may take a broader macro view of investments and are known as **strategists**
- Analysts have come under **increased scrutiny** after some were found to be less than independent during the dot com boom and subsequent bust in 2001
- The SFC has issued “*Guidelines to Address Analyst Conflicts of Interest*”

#### 4. INSTITUTIONAL INVESTORS

- An institutional investor will have **large amounts of money to invest** and can be an investment bank, brokerage house, mutual/pension fund, hedge fund, insurance company or charitable foundation
- A **passive institutional investor** usually holds a small stake in a listed company, taking little involvement in company management. A number of small stakes in different companies adds an element of diversification. Any abrupt acquisitions or disposals can increase short-term stock volatility
- An **active institutional investor** may invest in a substantial stake of a listed company on the assumption that the company’s shares are undervalued. If the investor supports company management it can be considered a “strategic investor”, while a “corporate raider” may take a less positive view of current management, looking to replace them

#### 5. RETAIL INVESTORS AND HIGH NET WORTH INDIVIDUALS

- **Retail investors** are usually individual investors, purchasing small amounts of securities, who invest for long-term investment or short-term profit
- With more education and increasing financial advisory services, the retail sector has experienced steady growth in Hong Kong
- **High net worth investors** are usually individuals with substantial amounts of money to invest, who are sought after as clients by brokers, financial advisers and private bankers

#### 6. ARBITRAGEURS

- **Arbitrage** is the making of risk-free profit by exploiting price differences of securities
- Arbitrage activity accounts for quite a substantial proportion of market turnover and contributes to market efficiency
- Examples of investment products used in arbitrage are depositary receipts and underlying stocks, and an index futures contract and the index’s constituent stocks
- In practice, most arbitrage activity involves securities listed on SEHK and futures traded on HKFE. Such arbitrage tends to be conducted by the **proprietary trading desks of EPs**

## 7. FINANCIAL ADVISERS AND PRIVATE WEALTH MANAGERS

- Financial advisers **assist individual investors** to develop their financial plans
- Once an adviser is familiar with a client's needs and limitations, an investment plan is developed, taking account of economic and tax environments
- Advisers help clients to achieve their goals
- The Hong Kong financial advising industry has grown significantly in the recent past
- Financial advisers are usually SFC licensed
- Financial advisers target a more general audience, while **private wealth managers** cater to the financial needs of HNWI and families
- Private wealth managers wish to be considered **objective and independent**
- Private wealth managers are regulated by the HKMA in the areas of banking and deposit-taking and by the SFC for securities and futures business

## 8. CREDIT RATING AGENCIES (CRAs)

- CRAs assign credit ratings to debt issuers, based on ability to pay debt obligations
- Reliance on credit ratings is an important aspect of managing credit risk
- The major CRAs include: Moody's Investor Services, Standard & Poor's and Fitch
- The SFC introduced regulations for the credit rating industry in 2011 after the problems encountered in 2007 and 2008

## 9. CUSTODIANS

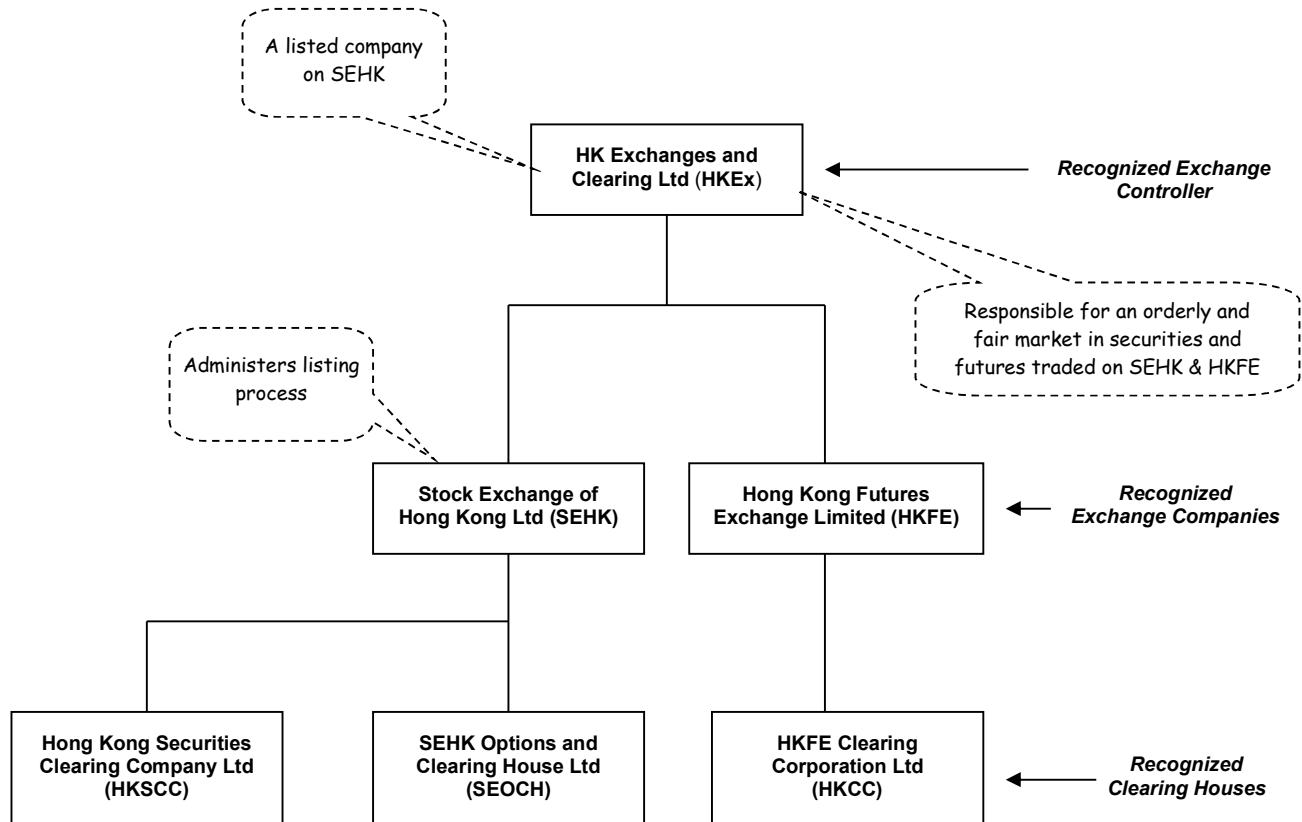
- An agent that holds and safeguards the assets of an individual, a financial institution or a corporation
- The Hong Kong custody market has grown significantly
- Major global banks now operate in the Hong Kong custody market, including Bank of New York Mellon Corporation, State Street, Citibank and Deutsche Bank

## 10. SHARE REGISTRARS

- Appointed by a listed company to maintain a register of shareholders
- Plays an important role in an IPO
- A list of Hong Kong registrars is available from SEHK
- Provides the following services for shareholders:
  - Distribution of dividends and bonus shares
  - Mailing of financial reports to shareholders
  - Transfer of shares
  - Issuance of share certificates
  - Distribution of investor communications

## 11. HONG KONG EXCHANGES AND CLEARING LIMITED AND ITS SUBSIDIARIES

### 11.1 Hong Kong Exchanges and Clearing Limited



- The SFC supervises and monitors the activities of all HKEx companies
- All exchange companies and clearing houses are 100% owned subsidiaries of HKEx

### 11.2 The Stock Exchange of Hong Kong Limited

- Responsible for overseeing the trading of listed companies on the stock exchange
- Objectives are to maintain an effective, fair and transparent stock exchange to protect investors and to ensure they have access to all required information

### 11.3 Hong Kong Futures Exchange Limited

- Responsible for the operation of the futures exchange in Hong Kong

### 11.4 Hong Kong Securities Clearing Company Limited

- Oversees clearing and settlement operations for all SEHK transactions
- EPs of the SEHK are required to settle all transactions through the Central Clearing and Settlement System (**CCASS**), except for stock options which are cleared through the Derivatives Clearing and Settlement system (DCASS)

### 11.5 The SEHK Options Clearing House Limited

- The commercial clearing house for standard contracts concluded in the stock options market, administered by SEHK

### 11.6 HKFE Clearing Corporation Limited

- Provides clearing services for derivatives contracts traded on HKFE, including a wide range of futures and options (except stock options)

### 11.7 OTC Clearing Hong Kong Limited

- Provides clearing and settlement services for eligible OTC derivative transactions
- 75% owned by HKEx; 25% owned by 12 financial institutions being its Founding Shareholders

### 11.8 The London Metal Exchange

- Acquired by HKEx in December 2012, it brings together participants from the physical and financial communities to create a robust and regulated market

## 12. REGULATORY BODIES

### 12.1 Hong Kong Monetary Authority

- Established in 1993, its main functions are:
  - Maintaining currency stability
  - Promoting stability and integrity of the financial system, including the banking system, by supervising licensed banks and deposit-taking companies
  - Helping maintain Hong Kong's status as an international financial centre
  - Managing the Exchange fund

### 12.2 Securities and Futures Commission

- An independent statutory body responsible for administering the laws governing the securities and futures markets in Hong Kong. Its main objectives are to:
  - Develop and maintain competitive, efficient, fair, orderly and transparent securities and futures markets
  - Help the public understand the workings of the securities and futures markets
  - Protect the investing public
  - Minimize crime and misconduct in the securities and futures markets
  - Reduce systemic risks in the securities and futures industry
  - Assist the Government in maintaining financial stability