

Client Alert: Revised Financial Return Forms

July 2020

On 26 June 2020, the Securities and Futures Commission (SFC) published the draft of the revised financial return form required to be submitted by licensed corporations (LCs) under the Securities and Futures (Financial Resources) Rules (FRR). This circular provides an overview of the amendments to financial return forms and explores key changes which are relevant to LCs with different types of business.

Why are changes needed?

The reviewing of LC's financial returns has been one of the key processes for the SFC to supervise and monitor LC's financial soundness and prudential risks. Although there is no change proposed for the FRR, the SFC considers that it is necessary to revise the financial return forms for **collecting additional data**, taking rapidly changing operating environment and greater business complexity into account. Through such additional data collection, the SFC is able to identify risks of LCs in a timely manner, take prompt supervisory action and protect investors.

Who will be affected?

The revised financial return form will affect **all LCs**. The extent of additional information required to be submitted under the revised financial return form depends on the nature of business engaged by LCs.

When will it be effective?

The SFC provides a "transition period" of a year. LCs are required to use the revised financial return form for accounting periods starting on or after **1 July 2021**. The SFC has stated that the revised form may be subject to non-substantive amendments. The final version will be published in the Government Gazette in due course.

What are the changes?

The key changes are largely related to additional information to be provided to the SFC. The below chart provides an overview of the key amendments to the FRR forms which may be applicable to LCs with different types of business.

Key changes which may be relevant to all LCs

Form 1

- LCs will be required to provide analysis of **top five banks** holding the largest aggregate amount of money for LCs in accounts other than segregated accounts

Form 3

- Uncommitted credit facility is added as a new type of credit facility for LCs to select

Form 6

- For top 20 rolling balance cash clients, LCs will be required to report the ratio of account balance to market value of securities holdings and provide **details of top three securities** for each client

What are the changes? (Cont.)

Key changes which may be relevant to all LCs (Cont.)

Form 7

- It is clarified that transactions in stock options contracts should be included as “futures and options dealing” and “trading profit and loss in futures and options contracts”
- Thresholds for determining material income/ expense items and for disclosing breakdown of gross interest income/ expense are changed. Income/ expense items will be viewed as material, which are required to be specified, when these items exceed 30% of total income/ total overheads respectively. LCs will be required to provide breakdown of gross interest income/ expense items when they exceed 30% of the total income/ total overheads respectively
- LCs will be required to disclose **management fees charged on/ by group companies** by their natures, including trading profit/loss sharing, expenses recharge and others

Form 12

- The SFC has enhanced notes to provide further guidance for LCs in determining number of active clients
- LCs will be required to provide further details of active clients by:
 - providing number of active rolling balance cash clients into a newly added service type
 - reporting number of active clients, to whom LCs provide services of (i) advising on securities or futures contracts (ii) advising on corporate finance; and (iii) asset management services, into separate sub-categories
 - disclosing number of active clients by **geographical locations** of clients
 - reporting active clients by **client types**, including institutional professional investors, corporate professional investors, individual professional investors, and others

Key changes which may be relevant to LCs holding proprietary positions

Form 1

- For proprietary positions in securities and specified investments, LCs will need to disclose balances by **product types** and provide **additional details** of investments with market values exceeding **10% of the excess liquid capital**

Form 10

- LCs will be required to report the breakdown of exchange-traded options into four sub-categories, namely purchased unlisted options, purchased listed options, written unlisted options and written listed options
- **Derivative warrants** listed on an exchange will be required to be classified as **exchange-traded listed options**

Key changes which may be relevant to LCs carrying on securities margin financing activities

Form 3

- LCs will be required to disclose **total market value of margin client securities re-pledged**

Form 4

- For LCs with total unadjusted loan balance exceeding HK\$1 billion, they will be required to disclose information of the **top 50 margin clients**. For other LCs, they will be only required to disclose relevant information of the top 20 margin clients
- LC will need to provide the loan to collateral ratio for each margin clients reported
- Where the total amount of outstanding margin call of all margin clients exceeds 25% of the shareholders' funds of LCs, LCs will be required to provide information related to analysis on **age of outstanding margin calls**
- For all relevant forms, LCs will be allowed to report ISIN code as an alternative to SEDOL number

Form 5

- LCs will not be required to disclose shares or warrants with concentration discounting factor below one

What are the changes? (Cont.)

Key changes which may be relevant to LCs dealing in futures and options

Form 1

- Regarding ranking liabilities relating to futures & unlisted options contracts (which arise from section 40 of the FRR), LCs will be required to **report breakdown** of ranking liabilities arising from house account and client account

Form 2

- For outstanding futures and unlisted options contracts held on behalf of clients, LCs will be required to report initial margin requirements and amounts of margin required to be deposited by (i) product types; and (ii) relevant markets traded

Key changes which may be relevant to LCs holding client assets

Form 8

- LCs will be required to provide breakdown for client securities held for clients, to whom LCs provide (i) services of advising on securities/ futures contracts/ corporate finance; (ii) asset management services; and (iii) automated trading services, into separate sub-categories
- Under analysis of client securities held by locations, there are certain **newly introduced sub-categories** for LCs to report. Examples of additional sub-categories include client securities pledged to intermediaries licensed for dealing in securities, client securities deposited to overseas banks, etc.
- LCs will be required to provide further information of **top three locations** where the largest amount of client securities held in other locations or for other purposes. LCs will also need to report details of **top three affiliates** holding the largest amount of client securities
- For client money held in segregated accounts, LCs will be required to disclose details of **top five** (i) authorized financial institutions/ other approved persons; (ii) approved banks incorporated outside Hong Kong; and (iii) other overseas counterparties holding the largest aggregate amount of client money

Key changes which may be relevant to LCs with securities borrowing and lending agreements/ Repo transactions

Form 1

- LCs will be required to **separately disclose the breakdown** of amount receivable/payables arising from securities borrowing and lending agreements/ repurchase transactions

Form 7

- LCs will need to separately disclose breakdown of income, interest income and interest expense arising from securities borrowing and lending agreements/ repurchase transactions

Key changes which may be relevant to LCs managing assets for their clients

Form 12

- LCs will be required to provide the net value of assets under management **by strategies** (including hedge fund strategies, private equity strategies, passive index tracking, and other strategies) and by types of accounts. There are certain **newly introduced types of accounts**, e.g. discretionary accounts held by affiliates or held by other individuals, etc.

What actions should be taken by LCs?

- **Understand and identify the key changes** that are relevant to you;
- **Design and test the processes** which are critical to collect the additional information and data required under the revised financial return forms; and
- **Enhance relevant systems** if it is necessary.



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