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通告 CIRCULAR

Subject: Compliance Bulletin (Issue No. 2) – (i) Investor Eligibility Requirement (ii) Dealings with Suspended Exchange Participants (iii) Stock Connect Northbound Trading

Enquiry: surveillance@hkex.com.hk

As part of our continuous efforts to promote transparency and compliance culture of our marketplace, the Exchange has prepared a Compliance Bulletin to offer the industry a better understanding of our enforcement work and regulatory expectation. It includes some common deficiencies and related issues identified and good practices observed, covering (i) Investor Eligibility Requirement (ii) Dealings with Suspended Exchange Participants and (iii) Stock Connect Northbound Trading.

The Exchange would like to point out that the above examples are by no means exhaustive and Exchange Participants (“EPs”) should always take into consideration their own circumstances to adopt appropriate internal controls and measures to ensure the compliance of relevant rules and requirements.

EPs are strongly advised to review their current set up and implement appropriate measures to strengthen their controls. Any identified non-compliance incidents should be reported to the Exchange as soon as practicable.

EPs are also encouraged to contact the Market Surveillance and Monitoring Department (email: surveillance@hkex.com.hk) should they have any questions on the above.

Felix Wang
Head
Market Surveillance and Monitoring
Operations Division

This circular has been issued in English together with Chinese translation of the same. If there is any discrepancy between the Chinese translation and the English version, the English version shall prevail.



COMPLIANCE BULLETIN

Issue No. 2

HKEX
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Contents

01 | **Investor Eligibility Requirement**

02 | **Dealings with Suspended EP**

03 | **Stock Connect Northbound Trading**



Investor Eligibility Requirement



Investor Eligibility Requirement

ChiNext and STAR Shares	Chapter 37 Bonds	SPAC Securities
<ul style="list-style-type: none"><li data-bbox="150 306 537 380">▪ Institutional Professional Investors* (IPI) only<li data-bbox="150 434 658 634">▪ Where the direct client is an intermediary, CCEPs shall require such client to ensure that the underlying customers are IPIs only (<i>Rule 14B06(18) and 14A06(15)</i>)	<ul style="list-style-type: none"><li data-bbox="728 306 1147 380">▪ Professional Investors* (PI) only<li data-bbox="728 434 1236 634">▪ Where the direct client is an intermediary, EPs shall require such client to ensure that the underlying customers are PIs only (<i>Rule 525A</i>)	<ul style="list-style-type: none"><li data-bbox="1307 306 1727 380">▪ Professional Investors* (PI) only<li data-bbox="1307 434 1818 678">▪ Where the direct client is an intermediary, EPs shall require such client to ensure that the underlying customers are PIs only (<i>Rule 593(6), effective from 1 January 2022</i>) (see also note[^])

Note*: Professional Investors are persons falling under paragraphs (a) to (j) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (the “SFO”), and Institutional Professional Investors are persons falling under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the SFO.

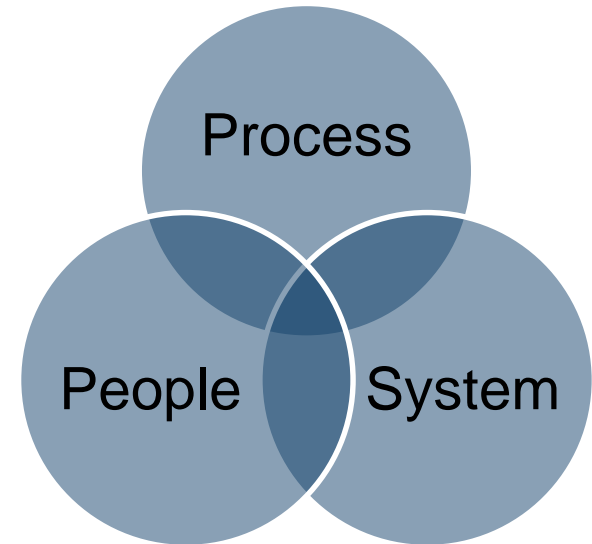
Note[^]: The subscription and trading of a Special Purpose Acquisition Company’s (SPAC) securities will be restricted to PIs only. This restriction would not apply to the Successor Company, whose securities would be freely transferable amongst all investor types (paragraph 149 of HKEX Consultation Paper on SPAC).



Investor Eligibility Requirement

Observations

- Violations **across brokers** with different background, size, business/operation model and clientele
- **One-third** of the violations related to **intermediary**
- Often involves a **mix** of factors:
 - ❑ **People** – insufficient understanding / misinterpretation of rules and requirements; misunderstanding of system functionality
 - ❑ **Process** – ineffective control design and implementation; no clear policies and procedures; manual process
 - ❑ **System** – complex system infrastructure; vendor issues



Investor Eligibility Requirement

Common Deficiencies and Good Practices

Common Deficiencies

- ✗ Misclassified client's PI types (e.g. Institutional PI vs Corporate PI) as a result of clerical mistakes, and/or staff's insufficient understanding of the regulatory requirement
- ✗ Trading access in restricted products granted to ineligible clients by system default, or as a result of clerical mistakes
- ✗ Insufficient arrangements (e.g. communicating regulatory requirement and outlining contractual obligation) in place to require the intermediary to observe the investor eligibility requirement

Good Practices

- ✓ Raise compliance awareness of the investor eligibility requirement
- ✓ Conduct diligent Know-Your-Client procedures (e.g. whether a client is an Institutional PI, Corporate PI, Individual PI or non-PI)
- ✓ Establish prior arrangements with client (e.g. to facilitate the unwinding of ineligible transactions)
- ✓ Establish additional arrangements with the intermediary

Investor Eligibility Requirement

Common Deficiencies and Good Practices

Common Deficiencies

- ✗ Orders in restricted products placed for ineligible client as a result of staff oversight, and/or staff's insufficient understanding of the regulatory requirement
- ✗ Failed to deploy system control in time (e.g. for covering STAR shares or ChiNext shares with stock code prefix 301XXX)
- ✗ Failed to deploy system control successfully due to insufficient understanding of the system functionality
- ✗ Failed to ensure system controls function as designed (e.g. due to static data feed issue, input error during deployment, or configuration error*)

Good Practices

- ✓ Adopt system control where possible
- ✓ Conduct thorough User Acceptance Test before deployment
- ✓ Conduct routine check on effectiveness of the system control
- ✓ Where manual override is allowed (i.e. soft block), follow maker-check process and maintain evidence and records for the special approvals
- ✓ Regular and timely communication with vendor and internal information technology team

Remark: An example of the system configuration error is that the system failed to effectively block non-Institutional PI from trading STAR shares that are also eligible for margin trading.





Investor Eligibility Requirement

Common Deficiencies and Good Practices

Common Deficiencies

- ✗ Post-trade review not put in place
- ✗ Inadequate review coverage (e.g. post-trade only covered trades conducted for direct clients but not the underlying clients of the intermediary)
- ✗ Incomplete coverage (e.g. not covering new products that are subject to the investor eligibility requirement)

Good Practices

- ✓ Conduct regular and appropriate post-trade review which covers all clients including the underlying clients of the intermediary
- ✓ Establish a designated function for the monitoring of trading activities
- ✓ Report incident of non-compliance to the Exchange as soon as possible upon identification



Possible Disciplinary Actions

Issuance of Compulsory Order

to issue a compulsory order to a Participant to unwind ineligible positions found to be in breach of the investor eligibility requirement within a prescribed time period

Imposition of Penalties

to impose a fine

Suspension of RO

to suspend or revoke the registration of a Responsible Officer

Suspension of Trading

to suspend, withdraw or revoke the right of a Participant's access to the System, or to restrict a Participant's trading activities on or through the Exchange

Suspension of Registration

to suspend a Participant from Participantships, or to suspend, withdraw or revoke an Exchange Participant's registration as a China Connect Exchange Participant or its use of or access to the China Connect Service or the CSC

Note: for details on the Exchange disciplinary powers, please refer to Chapter 7 of the [SEHK Rules](#)



Reference

Hyperlink

Definition of “Professional Investor” under SFO

- Securities and Futures Ordinance (*Schedule 1*) [Link](#)
- Securities and Futures (Professional Investor) Rules [Link](#)
- Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (*Section 15 – Professional Investors*) [Link](#)

Investor eligibility requirement for trading of:

- ChiNext and STAR shares SEHK Rules 14A06(13)-(15), 14B06(16)-(18)) [Link](#)
- Chapter 37 bonds SEHK Rules 525A [Link](#)
- SPAC securities SEHK Rules 593(6)
Effective from 1 January 2022 [Link](#)

Exchange disciplinary powers

SEHK Rules 702 [Link](#)



Dealings with Suspended Exchange Participants



Dealings with Suspended Exchange Participants

Relevant requirements

i. Rules of the Exchange (“SEHK Rule”)

- Rule 541 Dealings with Suspended Exchange Participants
- Rule 606 Professional Conduct

ii. Circulars

- SEHK Rule 541 – Dealings with Suspended Exchange Participants (Ref. No. [MSM/012/2021](#))

Common Deficiencies

Suspended Exchange Participant

- ✗ Failed to state its trading suspension status when it sent the clients’ orders to another Exchange Participant for execution
- ✗ Failed to inform its clients regarding its suspension and the detailed arrangement on handling clients’ orders in a timely and proper manner
- ✗ Failed to notify the Exchange of any breach, infringement of or non-compliance with any of the Rules or the Regulations, as defined in SEHK Rules, by itself or any other Participant

Appointed Exchange Participant

- ✗ Failed to identify that the Exchange Participant for which it executed orders was in trading suspension status
- ✗ Failed to apply for the necessary waiver under SEHK Rule 541 from the Exchange before dealing with the Suspended Exchange Participant due to lack of knowledge of the relevant requirements

Good Practices

- ✓ Have appropriate and effective measures in place, and take reasonable steps to ensure that the Exchange Participants they deal with are not in suspension status (Note 1), unless prior approval has been obtained from the Exchange
- ✓ Report the violation of HKEX rules to the Exchange as soon as possible



Note 1: Suspension of trading is publicly announced through [participant circulars](#) and “[Participant Information Changes \(SEHK\)](#)” on HKEX website. The full list of current Participants and their respective trading status is also available on [HKEX website](#). This includes Exchange Participants with “Non-Trading”, “Suspend-Trading” and “Ceased Trading” trading status.

Stock Connect Northbound Trading



China Connect – Northbound Trading

Surveillance and Monitoring at “BCAN” level

- Surveillance and Monitoring of CCEPs’ Northbound trading activities are conducted at “**BCAN**” level.
- Pursuant to Rule 1432 of the Rules of The Stock Exchange of Hong Kong Limited, a CCEP, shall, among others, comply with and abide by all applicable laws with regard to the trading of China Connect Securities on the relevant China Connect Market.
- In the event that the Exchange is notified by a China Connect Market Operator that there is reasonable cause to suspect or believe that a China Connect Exchange Participant or any of its clients has failed to comply with or has breached any applicable laws of Mainland China with regard to the trading of China Connect Securities on the relevant China Connect Market through the use of the China Connect Service, the Exchange may exercise the powers specified in Rules 1437(1)-(3) of the Rules.



China Connect – Northbound Abnormal Trading Activities

Major Types of Abnormal Trading Activities

Maintaining at Price Limit	Orders are massively, continuously or intensively placed in order to maintain the trading price of a stock at the upper or lower limit price.
Pumping and Dumping	Orders are massively, continuously or intensively placed, or executed at a price obviously deviating from the last closing price, resulting in a significant rise or decline in the trading price of the stock.
Fictitious Orders	A large number of orders not intended to be executed are placed and cancelled to induce, mislead or influence other investors in their trading decision-making.
Wash Trading	Trades are conducted between accounts under same control and/or affiliated accounts in order to affect the trading price or volume of a stock.
Abnormal Order Placement Rate*	Orders are intensively placed within a short period of time so as to aggravate the abnormal fluctuation in the price of such stock.

* Abnormal order placement rate applied to Highly Fluctuated Stocks of ChiNext / STAR only.

Rules Governing the Real-Time Monitoring of Abnormal Trading of Stocks:

- ChiNext Market of Shenzhen Stock Exchange (for Trial Implementation) / 《深圳证券交易所创业板股票异常交易实时监控细则（试行）》 (Link: [Chinese](#) only)
- STAR Market of Shanghai Stock Exchange (for Trial Implementation) / 《上海证券交易所科创板股票异常交易实时监控细则（试行）》 (Link: [Chinese](#) / [English](#))



China Connect – Northbound Abnormal Trading Activities

Maintaining at Price Limit

Continuous Auction Session

- Stock is traded at price limit
- Outstanding order at price limit \geq 1 million shares or RMB 10 million and \geq 30% of total market quantity at price limit, for 10 minutes or longer

Closing Call Auction Session

- At the end of the Continuous Auction Session (“CAS”), stock is traded at price limit
- At the end of the CAS and the Closing Call Auction Session (“CCAS”), market-wide outstanding orders at price limit \geq 1 million shares or RMB 10 million
- At the end of the CCAS, outstanding orders at price limit entered during CCAS \geq 300k shares or RMB 3 million
- At the end of the CCAS, outstanding orders at price limit \geq 30% of total market quantity at price limit



China Connect – Northbound Abnormal Trading Activities

Price pumping and dumping

Opening Call Auction Session

- Trading volume or amount \geq 300k shares or RMB 3 million
- Trading volume \geq 30% of total market volume
- Opening price increases (decreases) \geq 5% (3% for ST stocks)
- When the opening price reaches the price limit, order size \geq 10% of total market quantity at price limit (ChiNext only)

Continuous Auction Session

- Execution price shows an upward trend or downward trend
- Trading volume or amount \geq 300k shares or RMB 3 million
- Trading volume \geq 30% of total market volume
- Trading price increases (decreases) \geq 4% (2% for SSE index constituents)
- Above situations occur within any 3-minute-period

Closing Call Auction Session

- Trading volume or amount \geq 300k shares or RMB 3 million
- Trading volume \geq 30% of total market volume
- Trading price increases (decreases) \geq 3% (2% for SSE index constituents)



China Connect – Northbound Abnormal Trading Activities

Fictitious Orders

Opening Call Auction Session

- Order price deviates from the previous closing price $\geq 5\%$ (ST stocks $\geq 3\%$)
- Aggregated order size $\geq 300k$ shares or RMB 3 million
- Aggregated order size $\geq 30\%$ of total market quantity (same buy/sell direction)
- Aggregated order cancellation rate $\geq 50\%$ aggregated orders entered
- A reverse sale is made at a price lower than the bid price, or a reverse purchase is made at a price higher than the offer price
- Virtual Reference Price increases (decreases) $\geq 5\%$ (ST stocks 3%)

Continuous Auction Session

Case 1

- Order placed at the 5 best prices
- Aggregated order size at the 5 best prices ≥ 1 million shares or RMB 10 million, and $\geq 30\%$ of total market quantity at the 5 best prices
- Aggregated Order cancellation rate $\geq 50\%$
- Above situations occur ≥ 3 times

Case 2

- Stock is traded at price limit
- Aggregated order size at price limit ≥ 1 million shares or RMB 10 million, and $\geq 30\%$ of total market quantity at price limit
- Aggregated order cancellation rate $\geq 50\%$ of aggregated order at price limit
- Above situations occur ≥ 2 times



China Connect – Northbound Abnormal Trading Activities

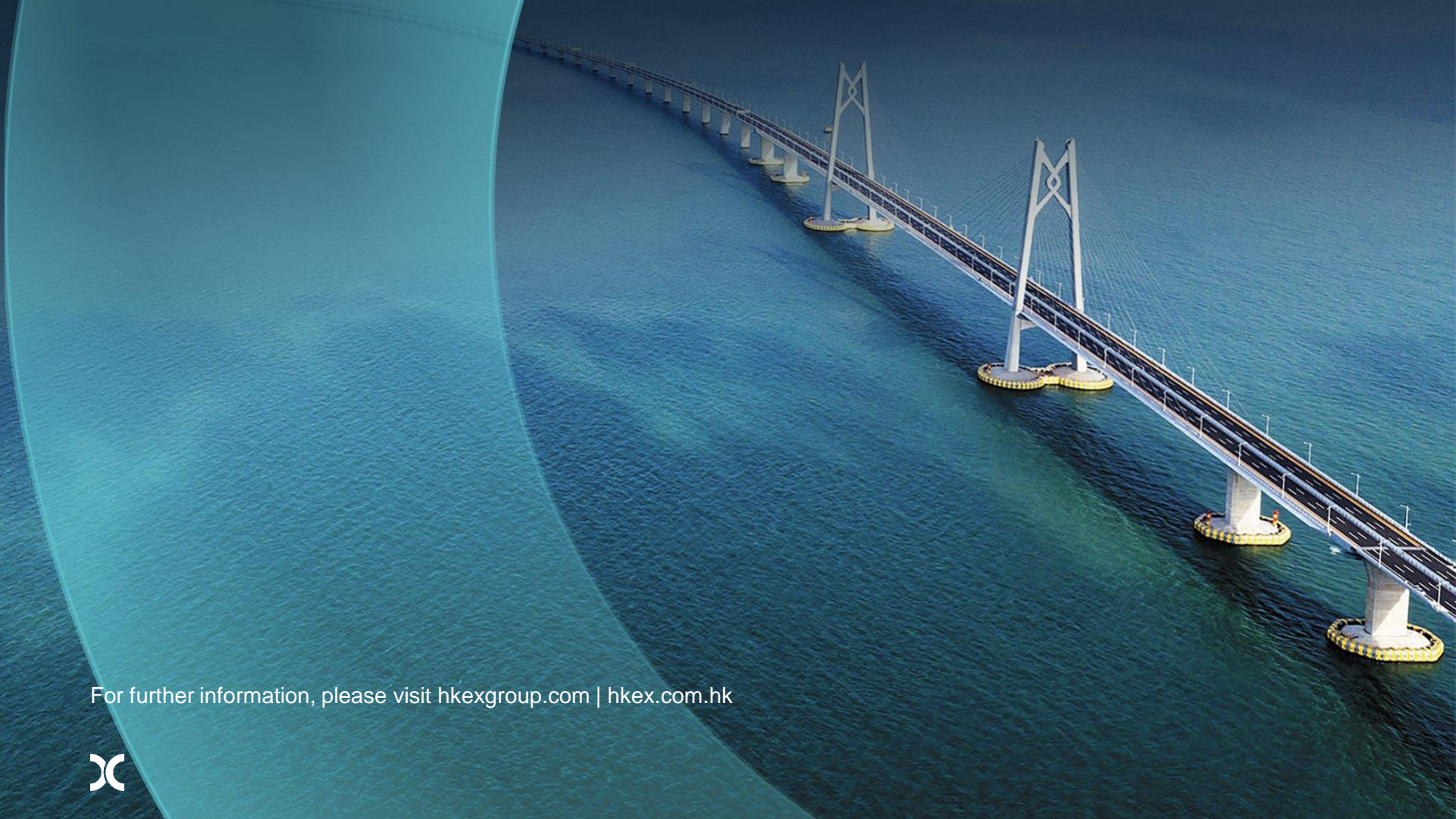
Wash Trading

- 10% of accumulated total daily stock turnover;
- 30% participation rate vs market turnover during closing auction (applicable to ChiNext/STAR only)

Abnormal Order Placement Rate *(Applicable to Highly Fluctuated Stocks of ChiNext/STAR only)*

- In the following 10 trading days, aggregated order size (within 1min during Continuous Auction Session) \geq RMB 10 million





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