



2022
ANNUAL ATTESTATION &
INSPECTION PROGRAMME

OPERATIONS
MARKET SURVEILLANCE & MONITORING

HKEX
香港交易所

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Agenda

01 | Overview of HKEX Rule Enforcement Framework

02 | 2022 Priority Areas

i | China Connect Northbound Trading

ii | Clearing Rules Obligations

iii | Risk Management



Overview of HKEX Rule Enforcement Framework



HKEX Rule Enforcement – Key Principles

Prevention

- Enhance industry understanding of HKEX Rules through:
 - ✓ Briefing sessions
 - ✓ Compliance Bulletin
 - ✓ Circulars, FAQs, guidance notes and reminders
 - ✓ Compliance Roundtable

Detection

- Identify non-compliance through daily monitoring and self-reporting by Exchange Participants / Clearing Participants
- Introduced **Annual Attestation and Inspection Programme** (since 2017):
 - ✓ Self-attestation of compliance with HKEX Rules
 - ✓ Onsite inspection
 - ✓ Thematic review

Correction

- Pursue corrective actions, depending on seriousness of breaches and violations:
 - ✓ Rectification measures
 - ✓ Disciplinary Proceedings
 - ✓ Standard Penalties



2022 Annual Attestation and Inspection Programme

Priority Areas

	2017	2018	2019	2020	2021	2022
Coverage	Cash Market	Cash and Derivatives Market				
	375 EPs	~800 EPs and CPs				
	SEHK Exchange Rules	SEHK, HKFE, HKSCC, SEOCH, HKCC Exchange and Clearing Rules				
Cash Market	Manual Trade				Manual Trade	
	Short Sell Order Flagging	China Connect	China Connect	China Connect	China Connect	China Connect
	China Connect					
Derivatives Market		Client Margin Requirements / Established Client	Position Limit LOP Reporting	Client Margin Requirements / Established Client		
Clearing Houses		Risk Management	Risk Management	Risk Management	Risk Management	Risk Management
						Clearing Rules Obligations
Compliance Advice Issued	12% [46]	11% [81]	12% [95]	6% [47]	6% [48]	-

Annual Attestation and Inspection Programme

Self-Attestation of Compliance

- Apply to **all Exchange Participants¹ and Clearing Participants²**
- Perform self assessment on compliance with relevant HKEX Rules
- Complete **Self-Attestation Questionnaire** prescribed by HKEX
- Submit the Questionnaire, along with any supporting documentation, via the **Electronic Communication Platform (ECP)**

Onsite Inspection

- Apply to **selected Exchange / Clearing Participants** based on risk assessment
- A more detailed evaluation of Exchange / Clearing Participants' compliance with the relevant HKEX Rules
- Inspectors will conduct **Onsite Inspection** at the participants' premises

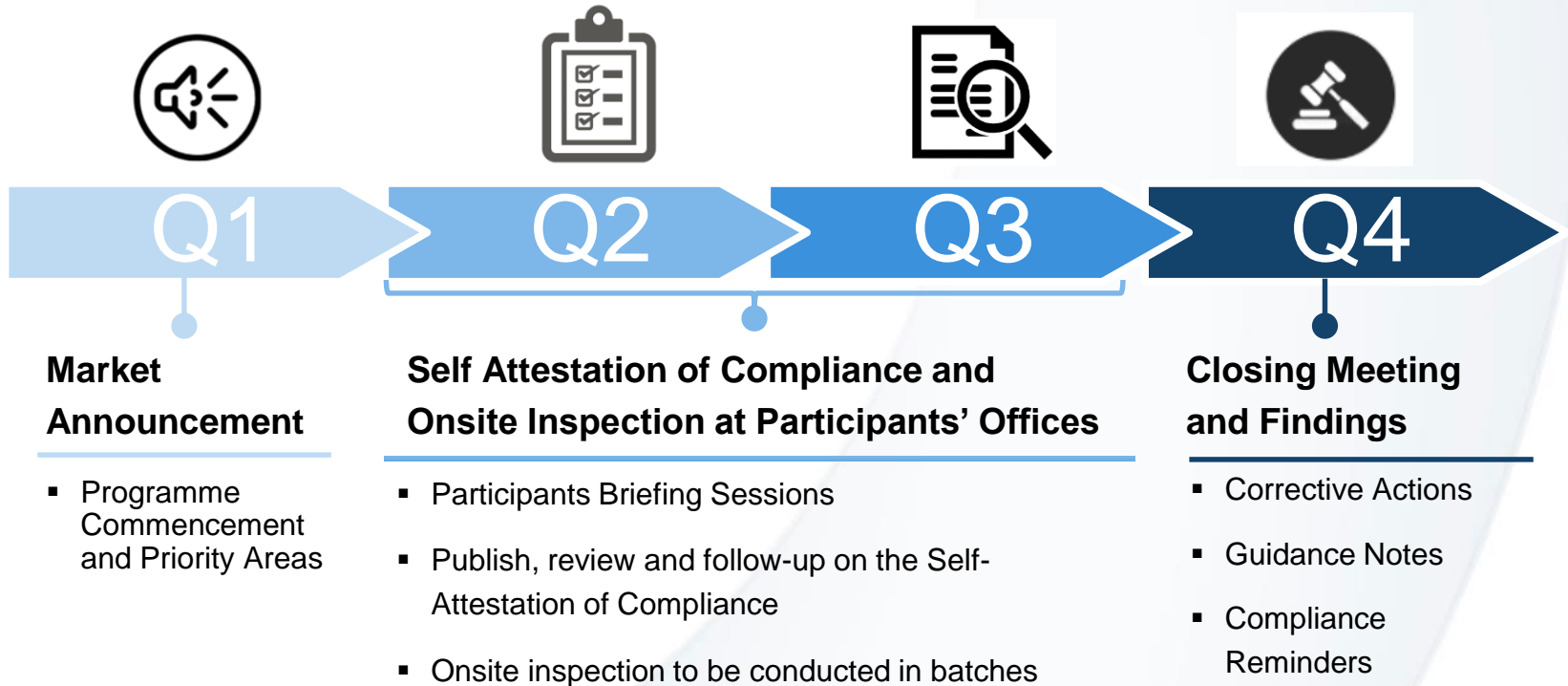
¹ Exchange Participants of The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited (the “**EPs**”)

² (i) Clearing Participants and General Clearing Participants of HKFE Clearing Corporation Limited, (ii) Direct Clearing Participants, General Clearing Participants and Custodian Participants of Hong Kong Securities Clearing Company Limited, and (iii) Direct Clearing Participants and General Clearing Participants of The SEHK Options Clearing House (the “**CPs**”)



Annual Attestation and Inspection Programme

Timeline



Onsite Inspection

Pre-Inspection Information Request

(4 weeks to prepare and submit)

- Documents and records that can demonstrate compliance of the relevant rules should be submitted to the HKEX Inspectors.
- These documents and records can be:
 - ✓ Policies, guidelines, manuals and procedures
 - ✓ Workflow / System flow
 - ✓ Internal training materials and records
 - ✓ Other relevant documents

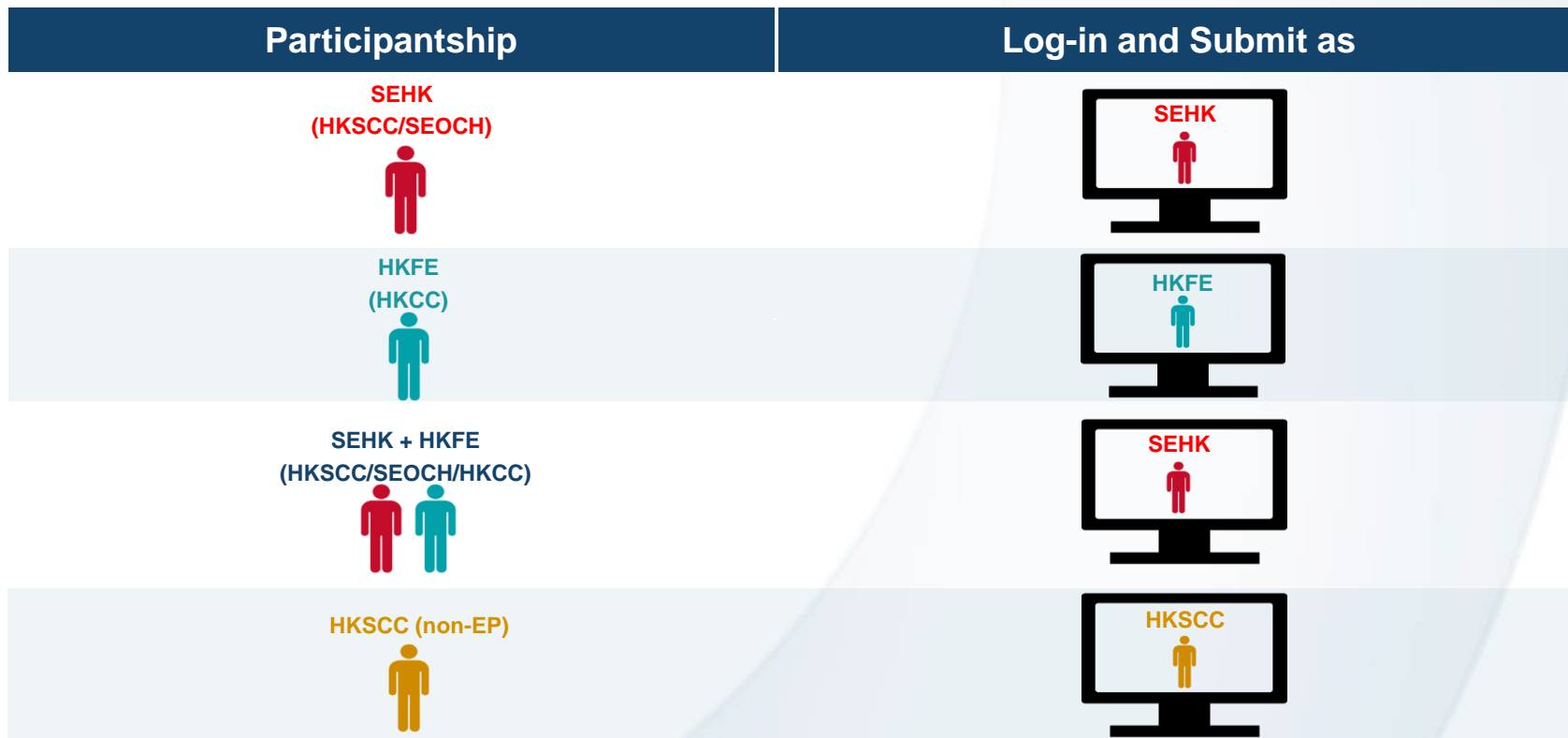
During Onsite Inspection

(<2 days)

- In general, the following staffs should participate in the onsite inspection meeting with the HKEX Inspectors:
 - ✓ Responsible Officers
 - ✓ Senior management with oversight of the relevant Priority Areas
(e.g. Head of Operations, Head of Compliance, Head of Risk Management, business heads etc.)
 - ✓ Experienced staff of the responsible areas
- Staff attending the meeting will be expected to describe their policy and procedures, walk through workflow / system flow, explain internal controls and processes, and answer any queries from the HKEX Inspectors.




Submission of Self-Attestation of Compliance via ECP



Link to ECP: <https://www.ecp.hkex.com.hk/>

ECP Administrator Contact: (Email) ecpadmin@hkex.com.hk or (Tel) 2840 3933

 **Note:** The Exchange has announced the plan to introduce a new communication platform (“ECP 2.0”) in early Q2 2022. The rollout of ECP 2.0 will **NOT** impact the questionnaire submission for the 2022 Annual Programme. Participants should submit the questionnaire via ECP 1.0. For details of ECP 2.0 rollout, please refer to https://www.hkex.com.hk/-/media/HKEX-Market/Services/Circulars-and-Notices/Participant-and-Members-Circulars/HKFE/2022/MO_DT_015_22_e.pdf for reference.

Reminders on Attestation Submission

Participants should:

- complete and submit on or before the submission deadline (Participant who does not engage in the priority areas is still required to complete and submit the questionnaire)
- complete and submit in editable form (do not modify the questionnaire or submit a scanned copy of the questionnaire) - *Adobe Acrobat is recommended*
- submit together with any supplementary information as **one file** in ".zip" format (no other zip file and no multi-level folders within the zip file) – *WinZip is recommended*
- limit your zip file to 4MB max
- note the zip file naming convention:
 - (a) Group 1 (SEHK, HKSCC and SEOCH participants) - MSM01_XXXXX_YYYYMMDD.zip; or
 - (b) Group 2 (HKFE and HKCC participants) - MSM04_XXXXX_YYYYMMDD.zip
- make sure the submitted questionnaire is **complete, true and accurate**



Reminders on Attestation Submission

The 2022 Self-Attestation of Compliance Questionnaire

- will be announced via Participant Circulars
- will be published on [HKEX Rule Enforcement website](#)
- will be embedded with data validation function

Action Now

- ✓ subscribe to [HKEX News Alert](#)
- ✓ make sure your ECP account is in active status



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- 1. News Releases
- 2. Updates to Rules and Guidance on Listing Matters
- 3. Updates to Trading Rules of the Stock and Futures Exchanges
- 4. Updates to the Rules of the Clearing Houses
- 5. Research Materials
- 6. Participant Circulars - The Stock Exchange of Hong Kong Limited (SEHK)
- 7. Participant Circulars - Hong Kong Securities Clearing Company Limited (HKSCC)
- 8. Participant Circulars - Hong Kong Futures Exchange Limited (HKFE)
- 9. Participant Circulars - HKFE Clearing Corporation Limited (HKCC)
- 10. Participant Circulars - The SEHK Options Clearing House Limited (SEOCH)
- 11. Member Circulars - OTC Clearing Hong Kong Limited (OTC Clear)

Update



2022 Priority Areas



General Observations

Policies and Procedures

Common Deficiencies

- Summarized applicable rules and regulations, but lacked details on controls to ensure compliance
- Inadequate on the policies and procedures coverage; some procedures set out details on part but not all of the controls / systems / order placing channels
- No regular review and revision

Compliance Reminder

- Comprehensive policies and procedures should be established to ensure ongoing compliance with the relevant rules and requirements
- Regular review and revision should also be conducted to ensure they are consistent, effective and up-to-date

Training

Common Deficiencies

- No adequate and product-specific training for responsible staff involved in the priority areas, both initially and on an ongoing basis
- Some merely relied on on-the-job training through sharing and coaching by senior staff members

Compliance Reminder

- To foster a culture of compliance, EPs should provide adequate and appropriate training to all its responsible staff, both initially and on an ongoing basis.



2022 Priority Areas

China Connect Northbound Trading



China Connect Northbound Trading

List of Enforcement Focus

1. **Broker-to-Client Assigned Number** (*SEHK Rule 1425A*)
2. **Investor eligibility requirement for trading of ChiNext shares and STAR shares**
(*SEHK Rules 14B06(16)-(18), 14A06(13)-(15)*)
3. **Trade Through Exchange Participant** (*SEHK Rule 590*)
4. **Odd lots** (*SEHK Rule 14A06(3), 14B06(4)*)
5. **Client agreement and risk disclosure** (*SEHK Rule 14A10, Rule 14B10*)
6. **Margin trading confined to Eligible SSE / SZSE Securities for Margin Trading**
(*SEHK Rule 14A15, Rule 14B15*)
7. **Pre-trade checking and post-trade monitoring**
(*SEHK Rules 14A06(4), 14B06(5), 14A06(9)-(10), 14B06(11)-(12), 14A17, 14B17, 1421(2), 1428(1), 1432 and 1433*)
8. **Foreign investors shareholding limit** (*SEHK Rule 14A08, Rule 14B08*)
9. **5% shareholding disclosure requirement** (*SEHK Rule 14A09, Rule 14B09*)
10. **Quota hogging** (*SEHK Rule 1428(1)*)
11. **Turnaround trading** (*not allowed under SEHK Rule 14A06(4), Rule 14B06(5)*)
12. **Off-Exchange trades or transfers prohibited** (*SEHK Rule 14A12, 14B12*)
13. **Stock borrowing and lending** (*SEHK Rule 14A16, Rule 14B16*)
14. **Naked short selling** (*not allowed under SEHK Rule 14A17, Rule 14B17*)

China Connect Northbound Trading BCAN Requirements

BCAN Assignment

Key Information

- One BCAN for one client
(Rule 1425A(1)(a), FAQ¹ 3 and 4)
- A separate BCAN for a client's joint account
(Rule 1425A(1)(b) and FAQ 18)
- Assign BCAN to affiliate's clients
(Rule 1425A(1)(d) and FAQ 6)
- Assigned BCAN cannot be changed or re-used
(Rule 1425A(1)(e) and FAQ 4)
- Assign BCAN to fund manager / fund per account opening arrangement
(FAQ 11)
- Set aside BCAN ranges for each TTEP
(FAQ 19)

Compliance Reminder

❌ Common Deficiencies

- Multiple BCANs assigned to same client due to rule misinterpretation, system deficiencies in handling client with multiple accounts, or clerical mistakes in manual process
- BCAN not assigned to affiliate's clients
- Changed BCAN without the Exchange's prior approval
- Failure to assign BCAN to fund manager / fund per the account opening arrangement
- Single BCAN assigned to a TTEP instead of a BCAN range

✅ Good practices observed

- Provide adequate and regular training to responsible staff
- Obtain sufficient client information for BCAN assignment and BCAN-CID Mapping File compilation
- Adopt automation to minimize manual input and conduct testing before launch, system migration or enhancement
- Implement maker-checker mechanism to detect human errors



¹ The FAQ on Northbound Investor ID Model ("FAQ") could be located on [HKEX website](#).

China Connect Northbound Trading BCAN Requirements

Accuracy of BCAN-CID Mapping File

Key Information

- BCAN-CID Mapping File should be accurate and up to date
(Rule 1425A(3) and FAQ 7)
- BCAN client type “3” for a fund
(FAQ 11 and BCAN-CID Mapping File Example¹)
- BCAN client type “4” for a fund manager or other legal entity
(FAQ 11 and BCAN-CID Mapping File Example)
- BCAN client type “5” for proprietary or principal trading of the CCEP/TTEP and/or its affiliate(s)
(FAQ 19 and BCAN-CID Mapping File Example)

Compliance Reminder

❌ Common Deficiencies

- Used incorrect BCAN client type (e.g., type 3 for fund manager, type 4 for fund and type 5 for non-affiliated client)
- Failed to correctly reflect changes to clients’ CIDs
- Incorrect input of client’s information / not inputted exactly as per the clients’ official identity documents
- Incorrect input of data in the designated fields
- Wrong inclusion of test / obsolete data

✅ Good practices observed

- Obtain accurate and sufficient client information for BCAN assignment and compiling BCAN-CID Mapping File
- Perform regular checks to ensure BCAN-CID Mapping File remains up-to-date and accurate
- Provide adequate and regular training to responsible staff
- Send BCAN client type change request to OTPC@hkex.com.hk



¹ Detailed examples are set out in “[BCAN-CID Mapping File Data Record Examples](#)”

China Connect Northbound Trading BCAN Requirements

Accuracy of BCAN-CID Mapping File

Examples of errors noted in the BCAN-CID Mapping File are set out below:

A. BCAN Client type

Scenario	Wrong Client Type Assigned	Correct Client Type
House accounts of non-affiliated clients	5	4
House accounts of <ul style="list-style-type: none">▪ CCEP▪ TTEP▪ CCEP's affiliates▪ TTEP's affiliates	4	5 (Note 1)
Fund Manager (Note 2)	3	4
Fund (Note 2)	4	3
Joint account (Note 3)	1	2

Note 1: BCAN for the house account should be within the BCAN range designated by its executing CCEP

Note 2: BCAN should be assigned to fund manager or individual funds in accordance with the account opening arrangement

Note 3: In addition to wrong client type assignment, the joint account was incorrectly submitted as one entry in the BCAN-CID mapping file



China Connect Northbound Trading BCAN Requirements

Accuracy of BCAN-CID Mapping File

B. Client Identification Data

- Failure to strictly follow clients' CID during the compilation process, resulting in:
 - i) Incorrect/ Incomplete input of client's name

Scenario	Wrong input	Correct input
<ul style="list-style-type: none">▪ Input of client's name in abbreviation form	"ABCSL"	ABC Securities Limited
<ul style="list-style-type: none">▪ Addition of internal remark after client's name to indicate account nature	"ABCSL – House Account" or "ABCSL – Client Account"	ABC Securities Limited
<ul style="list-style-type: none">▪ Client has no English name	"No English name", "Not Applicable", or "Null" under the English name field (Field No. 7 – 9)	(Note: CCEP should leave the field blank)



China Connect Northbound Trading BCAN Requirements

Accuracy of BCAN-CID Mapping File

B. Client Identification Data

ii) Incorrect / Inconsistent input of identity number (“ID”)

Scenario	Wrong input	Correct input
▪ ID does not match the official identity documents	“A1234567” or “A123456”	A123456(7)
	“123456”	CMY-123456
	“Error”, “No LEI” or “Not Applicable”	(Note: CCEP should input client’s ID per Certification of Incorporation (“ Col ”) or other official incorporation documents / LEI)
▪ Extra spacing, or omission of characters, numbers and symbols	“A123456 (7)”	A123456(7)
	“CMY123456”	CMY-123456
▪ Incorrect input of Business Registration number instead of ID per Col or other official incorporation documents / LEI	“88888888-123-45-67-8” (Note: Use of Business Registration number)	(Note: CCEP should input client’s ID per Col or other official incorporation documents / LEI)



China Connect Northbound Trading BCAN Requirements

BCAN Tagging

Key Information

- Tag correct BCAN each northbound China Connect order on a real-time basis.
(Rule 1425A(4) and FAQ 3)
- Promptly cancel any order tagged with an incorrect BCAN. If such order has been matched, then submit BCAN Error Report to the Exchange
(Rule 1425A(7))
- Consistently tag BCAN when submitting northbound trading orders for the fund manager or the fund
(FAQ 11 and Circular (Ref. No. CT/101/18)¹)

Compliance Reminder

❌ Common Deficiencies

- Manually placed an order in the wrong account, resulting in the wrong tagging
- Accidentally changed client's identity when the order was being processed by different systems within the organization
- Failed to follow the specified format when completing the BCAN Error Report

✅ Good practices observed

- Perform regular checks to identify and rectify any incorrect BCAN tagged as soon as possible
- Conduct proper testing procedures before launch, system migration or enhancement
- Provide adequate and regular training to responsible staff
- Use the enhanced BCAN Error Report template² with format checks and make sure the trade details are correct



¹ Circular (Ref. No. CT/101/18) is available on [HKEX website](#).

² The enhanced BCAN Error Report template with format check is available on [HKEX website](#).

China Connect Northbound Trading BCAN Requirements

BCAN Confidentiality

Key Information

- BCAN should be prepared in such a way not to bear any obvious link to a client's identity and must be kept strictly confidential
- In particular, the use and accessibility of BCANs (even within the CCEP or the TTEP) should be strictly restricted to a need-to-know basis
- CCEPs/TTEPs should lawfully handle and transfer clients' confidential information as contemplated under the NB Investor ID Model

(FAQ 4, 21 & 22)

Compliance Reminder

❌ Common Deficiencies

- Used clients' trading account numbers (in full or part) to form the BCANs
- BCANs were displayed in the general enquiry / trading screens of internal systems
- Used BCAN as an identifier for China Connect Northbound clients without masking the BCAN

✅ Good practices observed

- CCEPs and TTEPs implement controls and provide proper training to the relevant staff to ensure that BCANs are kept confidential
- Access is only granted to relevant parties under the need-to-know basis.
- Hide the BCAN data by only showing a mask code "*****" instead of actual BCAN data in the internal systems



China Connect Northbound Trading BCAN Requirements

BCAN Consent

Key Information

- A CCEP shall ensure that all necessary authorizations and written consents are obtained from each individual client.
- The CCEP/TTEP shall confirm with its client who refuses to provide the necessary consent that he/she has not otherwise provided such consent to other CCEPs/TTEPs for Northbound trading.

(Rule 1425A(5) and FAQ 15)

Compliance Reminder

❌ Common Deficiencies

- No BCAN consent before creating BCAN for the individual clients
- Issuance of one-way notification¹ to the clients instead of obtaining a written consent
- Incomplete consent wording presented to clients who request to trade in China Connect Northbound Trading
- Failed to follow up with clients who have refused to provide the BCAN consent

✅ Good practices observed

- CCEPs and TTEPs implement controls and provide proper training to the relevant staff to ensure that adequate BCAN consent is obtained properly
- CCEPs and TTEPs have proper controls in place to follow up the client who refused to provide BCAN consent

¹ As the NB Investor ID model is a newly-introduced arrangement, the purposes of use of personal data in connection with the NB trading arrangements under the NB Investor ID model will be use of personal data for a new purpose, in which case the requirement for CCEP/TTEP to obtain client's prescribed consent under Data Protection Principle 3 would be triggered unless the CCEP/TTEP has already obtained client's consent to use of personal data which is broad enough to cover use under these arrangements. Simple notification of the new arrangement will not be sufficient for these purposes.



China Connect Northbound Trading

Investor Eligibility Requirement for Trading of ChiNext Shares and STAR Shares

Key Information

- **Institutional Professional Investors¹ (“IPI”) Only**
- Where the direct client is an intermediate broker, CCEPs shall require such client to ensure that the underlying customers are IPIs only (*Rule 14B06(18) and 14A06(15)*)
- Any CCEP which fails to comply with the investor eligibility requirement repeatedly within a 12 month rolling period, will be liable to disciplinary action, including fines, suspension of trading or disciplinary proceedings (*Disciplinary Procedures to the SEHK Rules*)

Compliance Reminder

- ❌ **Common Deficiencies**
 - Insufficient prior arrangements (e.g. communicating regulatory requirement and outlining contractual obligation) in place to require intermediate broker to observe the investor eligibility requirement
 - Failure to keep abreast with regulatory changes and deploy corresponding controls in time (e.g. for covering STAR shares or ChiNext shares with stock code prefix 301XXX)
 - Inadequate user acceptance test (“**UAT**”) conducted before the deployment of any new or modified system control
 - Misclassification of client’s professional investor (“**PI**”) type
 - Failure to put in place any post-trade review exercise or post trade review exercise not diligently carried out, resulting a non-compliance incident left undetected for a prolonged period of time as a consequence



¹ Institutional Professional Investor as defined under paragraph 15.2 of the Code of Conduct for Persons Licensed by or Registered with the SFC, means a person falling under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance.

China Connect Northbound Trading

Investor Eligibility Requirement for Trading of ChiNext Shares and STAR Shares

✓ Good practices observed

Client Onboarding	Pre-trade	Post-trade
<ul style="list-style-type: none">✓ Providing adequate training (in addition to on-the-job-training) to staff✓ Conducting diligent know-your-client procedures to ascertain clients' PI type and trading capacity✓ Communicating with and regularly remind direct clients and intermediate brokers of the applicable regulatory requirements✓ Establishing control arrangements to require intermediate brokers to ensure that their underlying investors are IPIs	<ul style="list-style-type: none">✓ Adopting system controls where possible✓ Conducting thorough UAT (e.g. inclusion of all relevant testing scenarios pertaining to pre-trade control for investor eligibility requirement within the scope of the UAT) before system deployment✓ Performing regular system review (e.g. system code, functional settings, completeness of static data and effectiveness of data feed)✓ Confirming that the client or the underlying investors are IPIs where possible	<ul style="list-style-type: none">✓ Implementing post-trade review exercise for <u>timely</u> identification of any cases of potential non-compliance✓ Conduct regular post-trade review of trades conducted by both direct clients and the underlying investors of the intermediate brokers✓ Establishing a designated function for supervising the post-trade review exercise and reporting of incident



China Connect Northbound Trading

Trade Through Exchange Participants

Key Information

- EPs who are not registered as CCEPs but wish to provide services to their clients to trade in China Connect Securities may do so through other CCEPs for the account of their clients, **after** submitting a declaration to the Exchange, as TTEPs
- EPs shall not provide instructions to a CCEP or accept instructions from any client to sell or buy China Connect Securities through the China Connect Service which may be in breach of or not be in compliance with any provision in the applicable rules

(Rule 590(2) and (4))

Compliance Reminder

- EPs must not provide instructions to a CCEP, whether directly or indirectly, to trade in China Connect Securities for the account of their clients **before registering as TTEPs**
- Only TTEPs may trade through CCEPs. CCEPs shall not trade through another CCEP unless under contingency situation
- CCEPs should put in place adequate controls to ensure that their intermediate broker clients, who are **EPs and conduct trading for their clients, must be registered as TTEPs, both initially and on an on-going basis**



Q & A Session



2022 Priority Areas

Clearing Rules Obligations



Clearing Rules Obligations

List of Enforcement Focus

	Applicable Clearing House(s)
1. Continuing Obligations (CCASS Rule 1703 / SEOCH Rules 401 and 403 / HKCC Rule 214)	All
2. Access to CCASS / Installation outside office premises or in foreign jurisdiction (CCASS Rules 704 and 3901 to 3904)	HKSCC
3. Written Consent for Settlement Instructions (CCASS Rule 904)	HKSCC
4. Types of Clearing Accounts in DCASS (HKCC Procedures - Section 1.2 / SEOCH Procedures – Section 1.5.1)	HKCC / SEOCH
5. Assignment Mechanism for Stock Option Exercise Requests (SEOCH Procedures –Section 6.2.1)	SEOCH
6. Custodian Services in relation to Uncertificated Eligible Securities and/or China Connect Securities (CCASS Rules 823 to 824 and CCASS Operational Procedures – Section 7.14)	HKSCC
7. Arrangements with Settlement Agent (CCASS Rule 3802)	HKSCC
8. Voting Rights (CCASS Operational Procedures - Section 8.6.4)	HKSCC
9. Late Delivery or Payment of Isolated Trade (CCASS Rule 3404)	HKSCC
10. Exemption From Buy-in (CCASS Operational Procedures - Section 10.8.3)	HKSCC
11. Forced-sale Notice procedures on China Connect Securities (CCASS Rule 4110(iv))	HKSCC
12. Options Broker Exchange Participants' Individual Account (SEOCH Procedures - Sections 1.8, 1.8.1 and 1.8.2)	SEOCH
13. External Position Adjustment (SEOCH Procedures - Section 5.5)	SEOCH
14. Securities Collateral Balance (SEOCH Procedures - Section 7.2.4)	SEOCH



Clearing Rules Obligations

1. Continuing Obligations (applicable to HKSCC / HKCC / SEOCH)

Key Information

- Every Participant must at all times notify the clearing houses of any changes in the details supplied at the time of admission and thereafter, including but not limited to anything relating to such Participant, its directors or employees which would render inaccurate incomplete or superseded a statement or information previously furnished by such Participant to the clearing houses.

(CCASS Rule 1703 (iii) / SEOCH Rules 403(17) / HKCC Rule 214(n))

Key Highlights and Examples of Good Practice

- Participants need to submit “AC 13 - Change of Company Particulars and Contact Persons” via Client Connect to clearing houses¹
- Examples include changes in:
 - i. Designated officer / alternate designated officer (applicable to HKSCC Participants)
 - ii. Key contact persons for daily operations (applicable to HKCC / SEOCH Participants)
- ✓ **Good practices**
 - Provide adequate training and maintain comprehensive policies and procedures to ensure that its staff are aware of the continuing obligation requirements, and that any changes in the details of the Participant are reported to the clearing houses in a timely manner.



¹ See form and submission details in [https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/Forms/Securities-\(Hong-Kong\)/Clearing/Participation-Membership?sc_lang=en](https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/Forms/Securities-(Hong-Kong)/Clearing/Participation-Membership?sc_lang=en)

Clearing Rules Obligations

2. Access to CCASS / Installation outside office premises or in foreign jurisdiction (applicable to HKSCC)

Key Information

- Unless the prior written approval of HKSCC is obtained, CCASS Terminals and Participant Gateways can only be installed at the office premises of a Participant or its Settlement Agent.
- Each Participant must ensure that only persons approved as its Authorised Users are allowed access to CCASS via CCASS Terminals and/or via Participant Gateways.

(CCASS Rules 704 and 3901 to 3904)

Key Highlights and Examples of Good Practice

- To establish a new CCASS user, a Participant will need to apply to HKSCC by submitting the eService Form – SCard 1 “Smartcard Maintenance for User and DA”¹.
- To apply for access to CCASS from a foreign jurisdiction, the application form² should be submitted to HKSCC.
- Each smartcard is unique to the assigned CCASS user, and cannot be shared by other users or Participants.

✓ Good practices

- Adequate access controls shall be implemented to ensure that only persons approved as its Authorised Users are allowed access to CCASS.
- Examples of access controls include:
 - i. Maker-checker mechanism and proper audit trail for user role changes
 - ii. Regular re-certification of access granted
 - iii. User access profiles should be clearly defined



¹ See form and submission details in [https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/Forms/Securities-\(Hong-Kong\)/Clearing/Participation-Membership?sc_lang=en](https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/Forms/Securities-(Hong-Kong)/Clearing/Participation-Membership?sc_lang=en)
² See application form details in https://www.hkex.com.hk/-/media/HKEX-Market/Services/Clearing/Securities/Getting-Started/Settlement-Agent-and-Access-to-CCASS-from-a-Foreign-Jurisdiction/app_form.pdf

Clearing Rules Obligations

3. Written Consent for Settlement Instructions (applicable to HKSCC only)

Key Information

- Except in relation to Exchange Trades, China Connect Securities Trades, Clearing Agency Transactions, Investor Settlement Instructions, Transfer Instructions and Cross-border Transfer Instructions.
- Where the details input by the Participant contain information of or relating to **any person other than a Participant**, the Participant undertakes and confirms to HKSCC that it has **obtained the written consent of the relevant person** to input the information.

(CCASS Rules 904)

Key Highlights and Examples of Good Practice

- Written consent may be obtained in the form of consent letter, or client agreement etc.
- ✓ **Good practices**
- Comprehensive policies and procedures shall be maintained to ensure that proper written consent is properly obtained from the relevant person before inputting the Settlement Instruction.
 - Trainings shall be arranged to raise awareness of staff of such requirement.



Clearing Rules Obligations

4. Types of Clearing Accounts in DCASS (applicable to HKCC/SEOCH only)

Account Type	Natures of Trades and Positions *Please refer to <i>HKCC Procedures - Section 1.2 / SEOCH Procedures – Section 1.5.1</i> for details	Margin Basis
Individual Client Account	Must belong to one client only and such trades and positions are not held by a client operating an omnibus account .	Net
Market Maker Account	Recording of trades and positions arising from market making activities .	Net
Client Offset Claim Account	<ul style="list-style-type: none"> ▪ Individual clients of a HKCC/SEOCH Participant which are of an offset nature. ▪ Positions in each portfolio for offset claim must belong to the same client and no positions of a client may be allocated to the Client Offset Claim Account except with the client's prior consent. 	Maintained on a gross basis but margined on a net basis
Omnibus Client Account	Recording trades and positions of clients on an omnibus basis .	Gross
Other account types include (i) House Account, (ii) Daily Account, (iii) Sink Account and (iv) APT Account		

✔ Good practices

- Comprehensive policies and procedures shall be established to ensure that the DCASS Accounts are maintained in accordance with the natures of trades and positions of each clearing account.
- Regular review of clearing accounts shall be conducted to ensure no ineligible trades and positions in each clearing account.

Clearing Rules Obligations

5. Assignment Mechanism for Stock Option Exercise Requests (applicable to SEOCH only)

Key Information

- After assignment by DCASS, SEOCH Participants must perform a **random assignment of their clients' positions**, through their back office systems.

(SEOCH Procedures – Section 6.2.1)

Key Highlights and Examples of Good Practice

✔ Good practices

- Comprehensive policies and procedures shall be established to ensure that clients holding short options positions are assigned in a fairly manner through random assignment.
- Regular review of the **system logic**, if system is in use for such random assignment, shall be conducted to ensure the assignment is performed properly.

Q & A Session

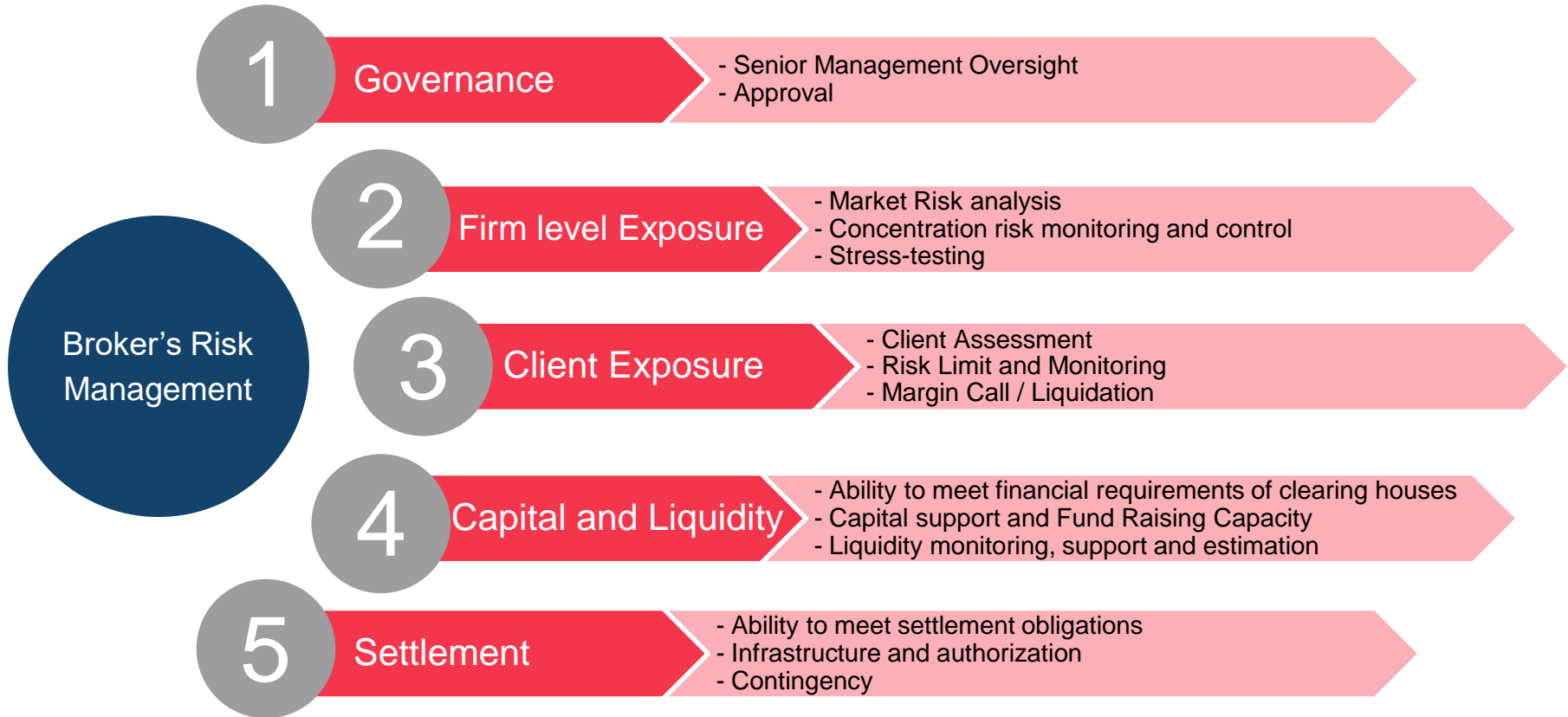


2022 Priority Areas

Risk Management



Risk Management Areas of Clearing Business



Risk Management

List of Enforcement Focus

- 1 **Stress Testing**
- 2 **Credit Exposure and Position Management (including Capital Based Position Limit)**
- 3 **Settlement Control and Monitoring**
- 4 **Notification of Change in Operations and Risk Control Plan**
- 5 **Risk Governance and Operational Capability**
- 6 **Third party service management, Business Continuity and Contingency Arrangements (including e-banking authorisation)**
- 7 **Non-Clearing Participant Management (for General Clearing Participant)**



Risk Management

1. Stress Testing

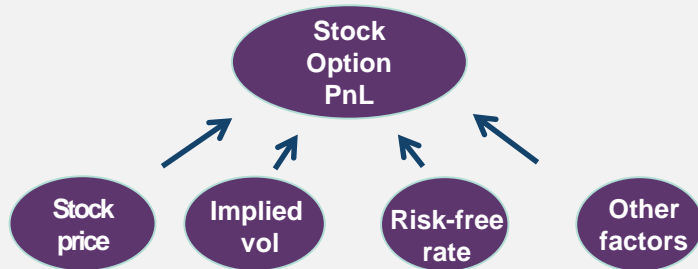
Key Information

Stress Testing of **non-linear products** (eg. options) is crucial since the losses of non-linear products increase exponentially under extreme scenarios.

Linear Products



Non-linear Products



Compliance Reminder

CPs are required to have **proper stress testing** for its own or clients' exposure on HKEX's products, especially on **non-linear products**

CPs are expected to implement and conduct stress testing regularly and at least on a **weekly basis**, to evaluate the maximum potential loss under extreme but plausible market conditions (e.g. +/- 20% and +/- 22% of market movement for index futures and stock options).

Proper stress testing policies and procedures should clearly set out:

- ✓ Methodology
- ✓ Frequency
- ✓ Review and escalation mechanism



Risk Management

2. Credit Exposure and Position Management (including Capital Based Position Limit)

Key Information

Client limits (e.g. position limits, credit limits and/or trading limits) are imposed by CPs on their clients for controlling their client exposure.

CPs shall implement appropriate and adequate monitoring arrangements, which include inputting the limits assigned to clients into the system for continuous monitoring.

Client limits, including limits set in third party systems, should be subject to regular review and integrate with the firm's credit risk management process.

Compliance Reminder

Lack of sufficient and effective monitoring and control on credit exposures

Common deficiencies

- ❌ CPs had not implemented any system to monitor their clients' positions against limits for their clients
- ❌ CPs had allowed clients to transact above the predefined limits and based on their clients' available fund instead
- ❌ Policies and procedures in relation to the treatment of outstanding loan payments were inadequate, where follow-up, escalation and provisioning/ write-off of such loans were not clearly set out
- ❌ Client limits, once granted, were not subject to regular review.



Risk Management

3. Settlement Control and Monitoring

Key Information

CPs should put in place adequate and comprehensive **internal controls** and procedures governing the settlement process.

Examples

- ✓ A **checklist** with maker-checker signoff over key settlement steps
- ✓ A **system dashboard** monitoring the timeliness in completing each key settlement steps with automatic escalation alerts

CPs should ensure that their staff has **adequate and up-to-date knowledge** on operational risk and control, payment obligations and the consequences of failure in meeting the obligations of the clearing houses.

CPs should also put in place funding estimation and position management procedures for collateral requirements (e.g. marks and margins) and settlement obligations, **particularly in handling exceptionally large positions.**

Compliance Reminder

Inadequate monitoring and controls over **Settlement Operations** for ensuring the timely completion of steps essential to fulfill the settlement obligation

Common deficiencies

- ✗ **Inadequate holiday backup arrangement of settlement and accounting officers**
- ✗ **Insufficient e-banking authorization**
- ✗ **Insufficient contingency funding channels (e.g. buffer, overdraft lines and FX facility)**
- ✗ **In review of funding sufficiency**

CPs rely on **internal position data** (instead of clearing houses' data/report) during the funding forecast/ arrangement process



CPs may **fail to capture errors** caused by internal system or manual process (eg. incorrect/ incomplete positions net-down in HKCC/ SEOCH)



Incorrect forecast of the settlement amount and may result in payment failure



Risk Management

4. Notification of Change in Operations and Risk Control Plan

Key Information

CPs should **notify** the clearing houses of any change in the details supplied at the time of admission

Examples

- ✓ **Updated** risk and control documents when engaging in **new business activities** such as proprietary trading, stock lending, China Connect market and margin financing

For filings of new business activities, information should be submitted to ClearingCreditRisk@HKEX.COM.HK

Please also refer to Circular MSM/004/2022 issued on 8 April 2022 for details.

Compliance Reminder

Failure to notify the clearing houses when there is a **change** in operations and risk control



Risk Management

5. Risk Governance and Operational Capability

Key Information

CPs should impose a **proper risk governance framework**, which includes establishment of a **risk management committee** for exercising senior management oversight over key risk areas, including

- ✓ Treatment of credit risk
- ✓ Control of concentration risk
- ✓ Monitoring of sufficiency of liquid capital

Compliance Reminder

Inadequate controls in relation to **Risk Management Governance**

Common deficiencies

- ✗ CPs did not keep proper meeting records/reports

Risk Management

6. Third party service management, Business Continuity and Contingency Arrangements (including e-banking authorisation)

Third party service management

Key Information

CPs should establish **proper review and testing procedures** in relation to **system changes** (e.g. system changes that has impact on settlement and margin calculation), which includes

- ✓ Thorough user acceptance testing and
- ✓ Parallel run

Compliance Reminder

Inadequate controls in relation to **system changes**

Common deficiencies

- ✗ Logic error during critical system enhancement made by third party system providers

Business Continuity Plan and Contingency Arrangements

Key Information

CPs should develop and maintain a business contingency plan to cope with disruptions that may impair CPs' ability to meet settlement obligations

Compliance Reminder

Inadequate arrangement in place to ensure its fulfillment of the clearing houses' **settlement obligations** under **contingency situation**



Risk Management

7. Non-Clearing Participant Management (for General Clearing Participant)

Key Information

General Clearing Participant (“**GCP**”) should **implement** control to manage its relations with Non-Clearing Participant (“**NCP**”), which includes:-

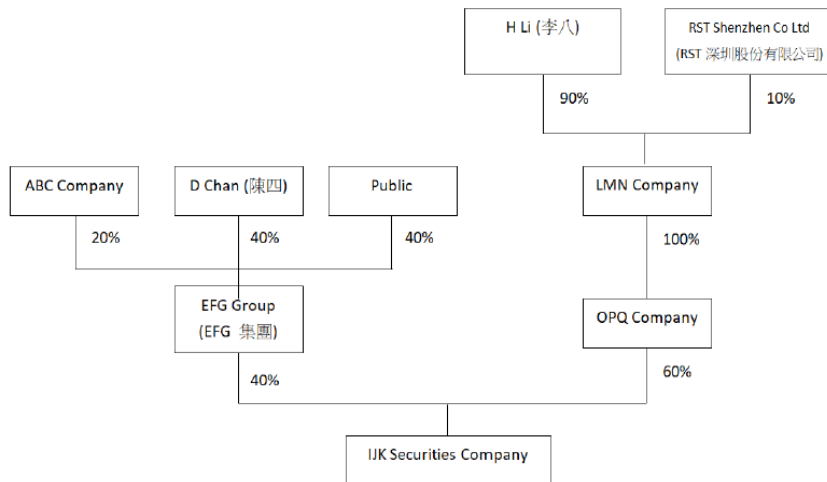
- ✓ **NCP on-boarding and termination** – on-boarding requirement and obligation/process for NCP termination
- ✓ **Trading/credit risk control and mitigation** – pre-trade and at-trade limit control, trading activity monitoring and exception authorisation
- ✓ **Default management** – NCP default and position close-out process
- ✓ **Day-to-day reporting and settlement operation** – Third-party clearing service related report, process and system (including backup systems)



Risk Management

Information Update

1. Contact Update (including emergency contacts)
2. Shareholding Structure Update
3. Notification of update of shareholding chart
4. Organisation Chart Update (including directors, senior management, ROs, department heads)
5. Resources and Staff Experience



Risk Management

Notification of update of shareholding chart

Key Information

CPs should **provide to clearing houses an updated shareholding chart***:-

- ✓ 1. **on an annual basis (via annual attestation)**
- ✓ 2. as soon as reasonably practicable subsequent to any reorganisation of its corporate group
- ✓ 3. as soon as reasonably practicable following a change (direct or indirect) of 10% of more in the share capital or voting rights

For filings following shareholding change under (2) or (3) above, information should be submitted to ClearingCreditRisk@HKEX.COM.HK using the template provided in the attestation submission pack

*Reference: HKSCC Rule 1703(viii), HKCC Rule 214A(a) and SEOCH Rule 403F



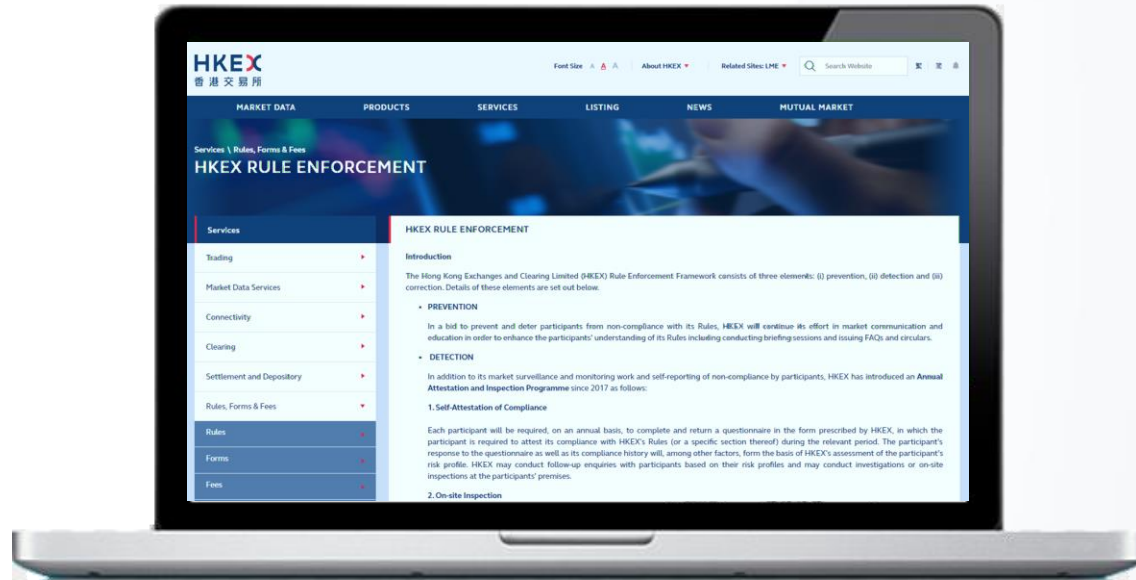
Q & A Session



HKEX Rule Enforcement Designated Website & Email Account



https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/HKEX-Rule-Enforcement?sc_lang=en



surveillance@hkex.com.hk



For further information, please visit hkexgroup.com | hkex.com.hk

