

A long-exposure photograph of a city street at night. The image shows light trails from cars and buses, illuminated buildings, and a street with tram tracks. The scene is vibrant with various colors from the city lights.

2023 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 | 2023 Priority Areas

i | China Connect Northbound Trading

ii | 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 sharing

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

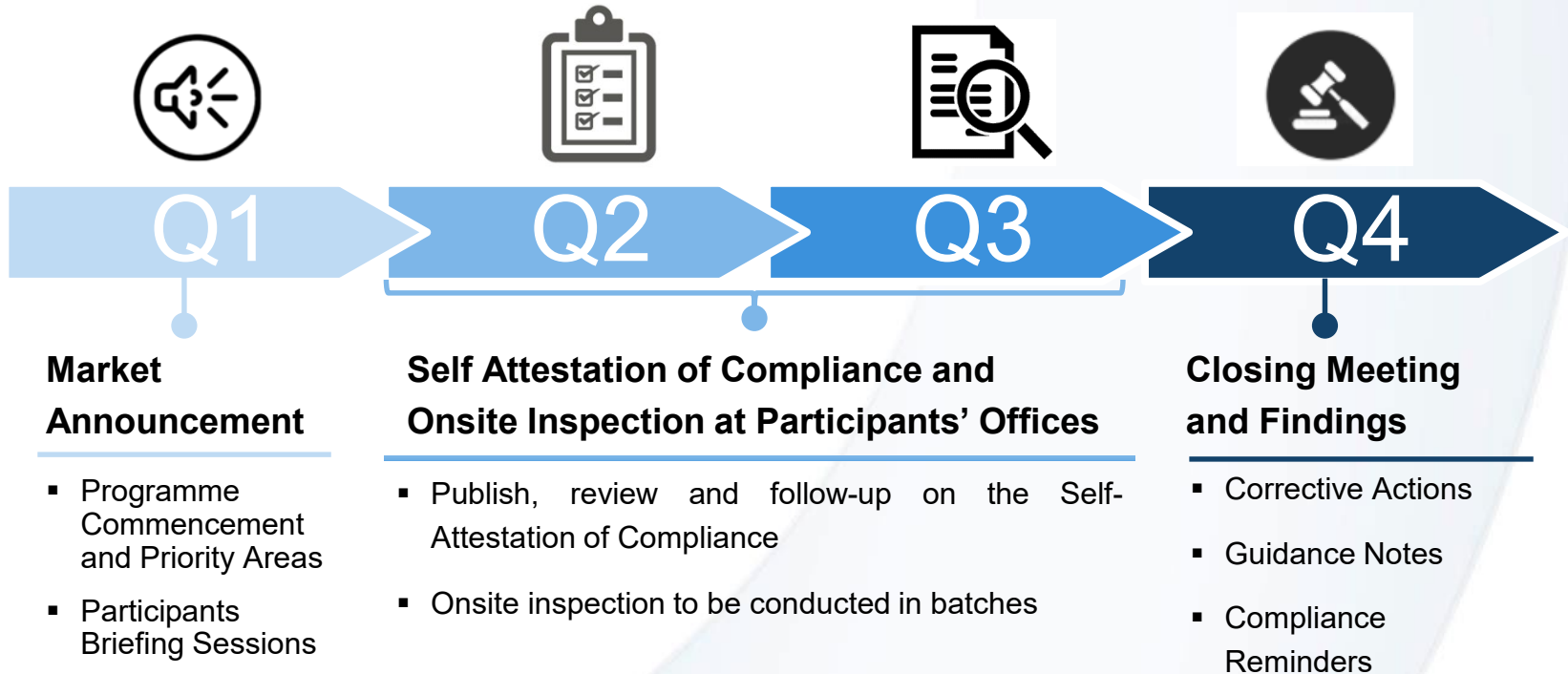
Correction

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



Annual Attestation and Inspection Programme

Timeline



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 2.0”)** *[New]*

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**”)



Onsite Inspection

Pre-Inspection Information Request

(4 weeks to prepare and submit)

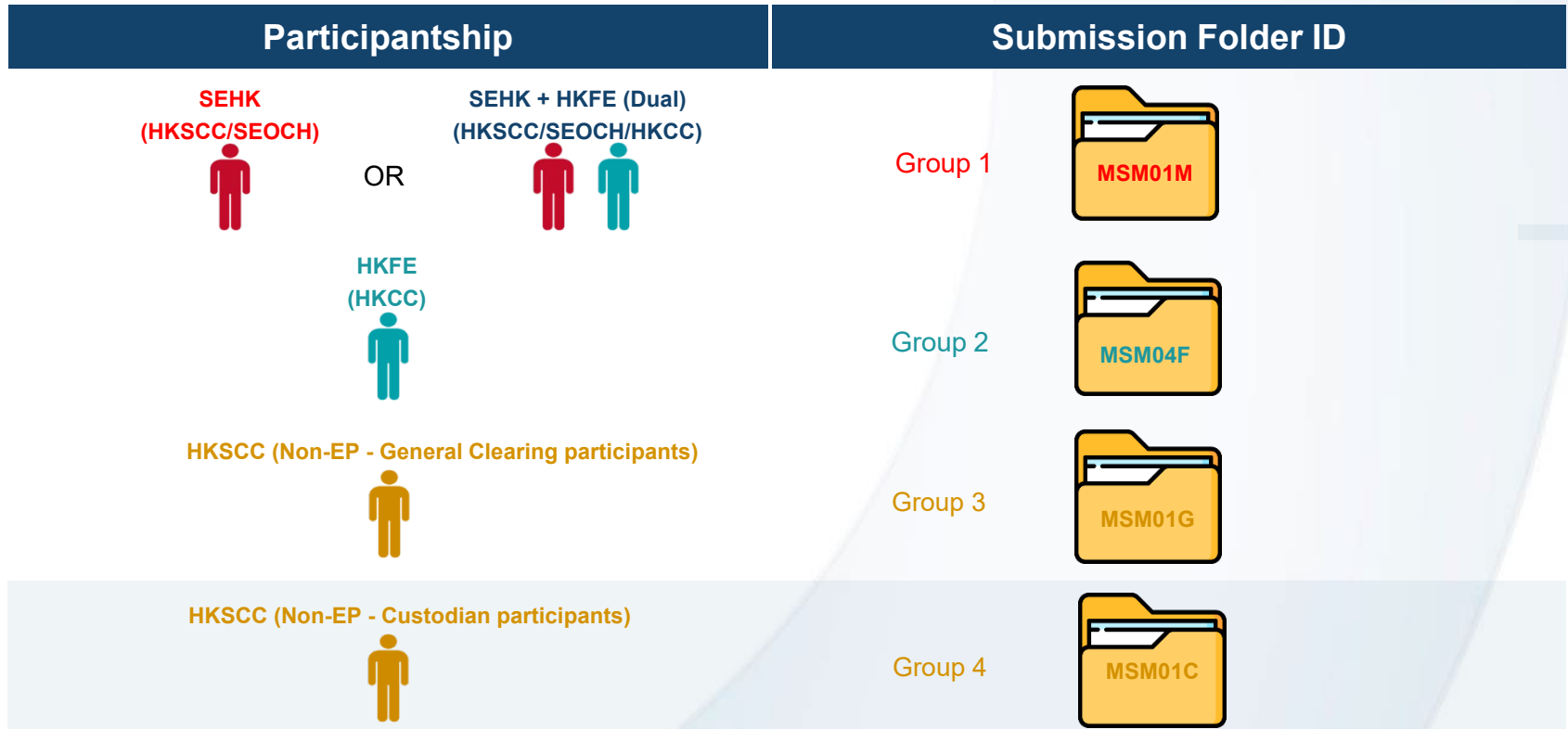
- Documents and records that can demonstrate compliance of the relevant rules should be submitted to the HKEX Inspectors prior to the onsite inspection meeting
- These documents and records can be:
 - ✓ Policies, guidelines, manuals and procedures
 - ✓ Workflow / System flow
 - ✓ Internal training materials and related 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 2.0”



Link to “ECP 2.0”: <https://ecp2.hkex.com.hk/>

“ECP 2.0” User Support Teams: Please refer to <https://www.hkex.com.hk/-/media/HKEX-Market/Services/Trading/Securities/Stamp-Duty-Reporting-and-Payment/ECP-and-Documentation/ECP-User-Guide/ECP2-Application-Form.pdf>

 “ECP 2.0” User Guide: https://www.hkex.com.hk/-/media/HKEX-Market/Services/Trading/Securities/Stamp-Duty-Reporting-and-Payment/ECP-and-Documentation/ECP-User-Guide/ECP2_frontend_userguide.pdf

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 **100MB max**
- Note the zip file naming convention:
 - (a) Group 1 (SEHK, HKSCC and SEOCH participants) - MSM01**M**_XXXXX_YYYYMMDD.zip; or
 - (b) Group 2 (HKFE and HKCC participants) - MSM04**F**_XXXXX_YYYYMMDD.zip; or
 - (c) Group 3 (General Clearing participants) - MSM01**G**_XXXXX_YYYYMMDD.zip; or
 - (d) Group 4 (Custodian participants) - MSM01**C**_XXXXX_YYYYMMDD.zip
- Make sure the submitted questionnaire is **complete, true and accurate**



Reminders on Attestation Submission

The 2023 Self-Attestation of Compliance Questionnaire will be ...

- Announced via Participant Circulars
- Published on [HKEX Rule Enforcement website](#)
- Embedded with data validation function

Action Now

- ✓ subscribe to [HKEX News Alert](#)
- ✓ make sure your “ECP 2.0” account is in active status



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<input type="checkbox"/>	4. Updates to the Rules of the Clearing Houses
<input type="checkbox"/>	5. Research Materials
<input checked="" type="checkbox"/>	6. Participant Circulars - The Stock Exchange of Hong Kong Limited (SEHK)
<input checked="" type="checkbox"/>	7. Participant Circulars - Hong Kong Securities Clearing Company Limited (HKSCC)
<input checked="" type="checkbox"/>	8. Participant Circulars - Hong Kong Futures Exchange Limited (HKFE)
<input checked="" type="checkbox"/>	9. Participant Circulars - HKFE Clearing Corporation Limited (HKCC)
<input checked="" type="checkbox"/>	10. Participant Circulars - The SEHK Options Clearing House Limited (SEOCH)
<input type="checkbox"/>	11. Member Circulars - OTC Clearing Hong Kong Limited (OTC Clear)

Update

HKEX
香港交易所

**WELCOME TO THE ELECTRONIC
COMMUNICATION PLATFORM
(ECP)**

Log on to the ECP through the following Authentication Systems:

HKEX Access Management Portal

SFC WINDS⁽¹⁾

(1) For SFC-licensed corporations and registered institutions

By logging into this website via HKEX Access Management Portal or the SFC's WINDS platform, you are deemed to have read and accepted the Terms and Conditions for Electronic Communication Platform, which have been confirmed that the individual's relevant personal data is processed in the use of this application consistent to the processing of their personal data in accordance with the privacy policy statement as incorporated and supplemented in the Terms and Conditions.

Unauthorized access and use are prohibited. HKEX reserves the right to take actions against offenders.

2023 Priority Areas



General Observations

Policies and Procedures

Common Deficiencies

- Summarized applicable rules and regulations, but lacked details on controls to ensure compliance
- Inadequate coverage in policies and procedures; 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 be conducted to ensure they are consistent, effective and up-to-date

Training

Common Deficiencies

- Lack of 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



2023 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. Margin trading confined to Eligible SSE / SZSE Securities for Margin Trading** (SEHK Rule 14A15, Rule 14B15)
- 5. Client agreement and risk disclosure** (SEHK Rule 14A10, Rule 14B10)
- 6. Odd lots** (SEHK Rule 14A06(3), 14B06(4))
- 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 limitation and 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
- Assigned BCAN to fund manager / fund not according to 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)
- CCEPs/TTEPs should remove relevant BCAN-CID mapping data from the BCAN-CID Mapping File the day before the effective date of resignation or cessation
(System File Interface Specification 2.1.1²)

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, etc.)
- 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
- Lack of adequate control over data accuracy regarding BCAN assigned by its affiliate to underlying clients
- Failure to remove BCANs (upload blank file) upon resignation or cessation of business

✅ Good practices observed

- Obtain accurate and sufficient client information for BCAN assignment and compiling BCAN-CID Mapping File
- Perform regular checks on all data in the BCAN-CID Mapping File, including but not limited to changes (e.g. addition/deletion/amendment) and timely reconciliation between internal system records and the BCAN-CID mapping file and/or request affiliate to perform regular review to ensure BCAN-CID Mapping File remains up-to-date and accurate
- 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](#)”

² The “Northbound Trading Investor ID Model - System File Interface Specification” could be located on [HKEX Website](#).

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)
<ul style="list-style-type: none"> ▪ Client's name on official identity document contains non-alphabetic characters, Chinese characters and symbols (e.g. 손진진 (孫眞眞)) 	"손진진" (Field No. 10)	손진진 (孫眞眞) (Field No. 10)



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
<ul style="list-style-type: none"> 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 / Legal Entity Identifier (“ LEI ”))
<ul style="list-style-type: none"> Extra spacing, or omission of characters, numbers and symbols 	“A123456 (7)”	A123456(7)
	“CMY123456”	CMY-123456
<ul style="list-style-type: none"> 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 to 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))
- Tagging BCAN in a consistent manner 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

- Human errors when processing high-touch orders and implementing new booking flow in the order system leading to incorrect BCAN tagging
- Incorrect BCAN mapping in the system leading to wrong tagging
- Erred in placing an order to a wrong client account, resulting in wrong tagging
- Accidentally changed client's identity details 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 system launch, migration or subsequent enhancements
- 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

- 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

- Displayed BCANs in the general enquiry / trading screens of internal systems defeating the principle of keeping BCANs in strict confidence
- Used BCAN as an identifier for China Connect Northbound clients without masking the BCAN
- Insufficient controls / arrangements to ensure the use of and accessibility to BCANs are strictly restricted on a need-to-know basis

✅ Good practices observed

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



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

- Failed to obtain BCAN consent before creating BCAN for individual clients
- Issued one-way notification¹ to clients instead of obtaining a written consent
- Presented incomplete consent wording to clients who requested to participate in China Connect Northbound Trading
- Failed to follow up with clients who have refused to provide 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 with the client who refused to provide BCAN consent

¹ As the NB Investor ID model is a relatively new arrangement, the purposes for the use of personal data in connection with NB trading arrangements under the NB Investor ID model will be regarded as use of personal data for a new purpose. In that case, the requirement for CCEP/TTEPs to obtain client's prescribed consent under Data Protection Principle 3 would be triggered unless CCEP/TTEPs have already obtained client's consent for the use of his/her personal data which is broad enough to cover the purposes for the NB trading. 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 new stock codes of STAR shares or ChiNext shares)
- 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



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

- ✓ Provide adequate training (in addition to on-the-job-training) to staff
- ✓ Conduct diligent know-your-client procedures to ascertain clients' PI type and trading capacity
- ✓ Communicate with and regularly remind direct clients and intermediate brokers of the applicable regulatory requirements
- ✓ Establish control arrangements to require intermediate brokers to ensure that their underlying investors are IPIs

Pre-trade

- ✓ Adopt appropriate system controls (e.g. hard block) where possible
- ✓ Conduct thorough UAT before system deployment
- ✓ Adopt automation to utilize product flagging directly from the websites¹ of SSE and SZSE, followed by reconciliation between the information obtained from the exchanges and third party vendor
- ✓ Perform regular system review (e.g. system code, functional settings, completeness of static data and effectiveness of data feed)
- ✓ Confirm the client or the underlying investors are IPIs, where possible

Post-trade

- ✓ Implement post-trade review exercise for timely identification of any potential non-compliance incidents
- ✓ Conduct regular post-trade review of trades conducted by both direct clients and underlying investors of intermediate brokers
- ✓ Establish a designated function to supervise the post-trade review exercise and reporting of incident



¹ Shanghai Stock Exchange ("SSE"): <http://www.sse.com.cn/assortment/stock/list/share/>
Shenzhen Stock Exchange ("SZSE"): <http://www.szse.cn/market/product/stock/list/index.html>

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

✘ Common Deficiencies

- CCEPs failed to check the trading capacity of their clients who are also EPs during on-boarding, overlooking the need to ensure their EP clients should have been registered as TTEPs before they could conduct trading through the China Connect Service for the account of their underlying clients
- CCEPs conducted China Connect trading activities through other CCEPs for principal and/or agency trading for purposes other than contingency situation

✔ Good practices observed

- 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**



China Connect Northbound Trading

Margin Trading

Key Information

- No China Connect Exchange Participant is allowed to provide funds or securities margin financing arrangements to any of its clients for the purpose of or with the view to facilitating the purchase of China Connect Securities not included in the List of Eligible SSE/SZSE Securities for Margin Trading¹

(Rule 14A15 and 14B15)

Compliance Reminder

❌ Common Deficiencies

- Failed to inform clients of the scope of services of margin trading
- Provided securities margin financing arrangement to clients to purchase securities by reference to the aggregated collateral values of all securities held in their portfolio without excluding China Connect Securities, which is not included in the List of Eligible SSE/SZSE Securities for Margin Trading

✅ Good practices observed

- Perform regular review on the system control to ensure that the control list is complete and up-to-date
- Adopt adequate controls to ensure that the aggregated collateral values of all securities held in the client's portfolio only included Eligible SSE/SZSE Securities for Margin Trading
- Check and ensure clients' understanding and awareness on the restrictions, requirements and conditions applicable to Margin Trading



¹ "The List of Eligible SSE/SZSE Securities for Margin Trading" can be found in [HKEX Website](#).

Q & A Session

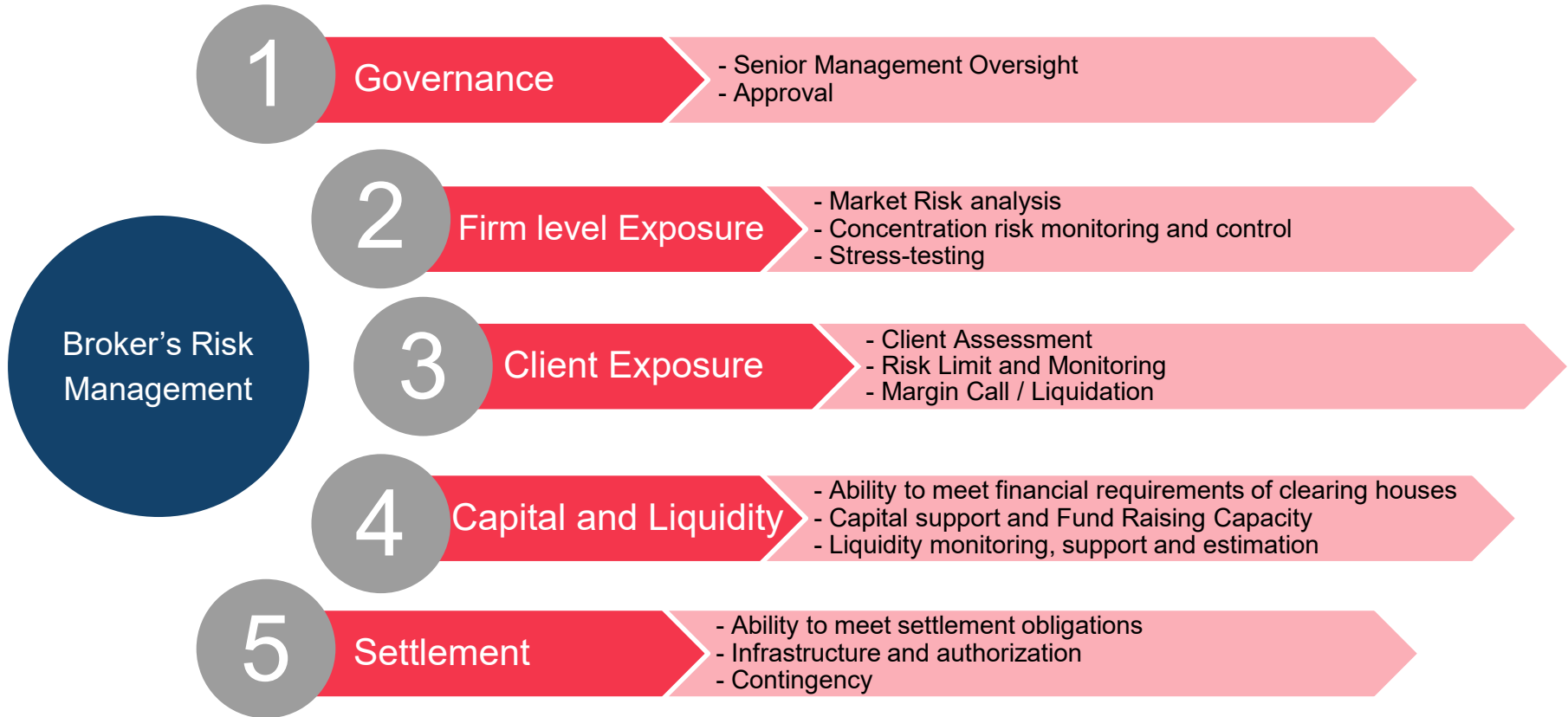


2023 Priority Areas

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

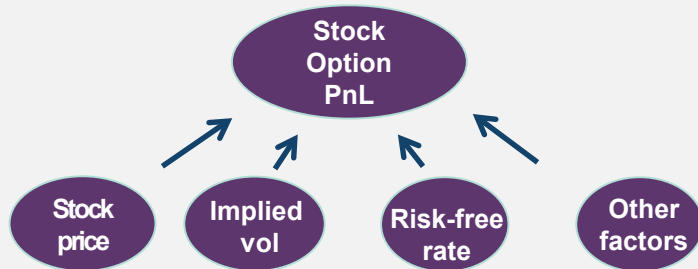
Key Information

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

3.1 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.

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

3.2 Settlement Control and Monitoring (Large Orders and DvP)

Key Information

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:**

- ✓ **Large trade order management** - which includes process to reduce the position for computation of collateral requirements (e.g. to provide Specific Cash Collateral / Specific Stock Collateral to HKSCC for large long / short stock positions under CNS);
- ✓ **Liquidity buffer to meet clearing obligations** - pre-allocating buffer funding to prepare for the potential increase between the collateral requirements estimates and its final amount;
- ✓ **Additional liquidity planning and exposure controls for trade that settled with client on DvP basis** – Since DvP clients are not providing stock/margin/cash upfront by the time of placing order, this may reduce the ability of broker to manage the marginable position by placing Specific Cash Collateral / Specific Stock Collateral. Therefore CP should review the exposure limit for these group of client and house liquidity to support the clearing of these trades.







Risk Management

3.3 Settlement Control and Monitoring (For Holiday Trading Clearing Participants)

Arrangement with appointed settlement bank and liquidity monitoring

Key Information

	Areas	Details
	Awareness of Clearing House Reports to review	<ul style="list-style-type: none">• Update settlement control checklist / dashboard with H day related settlement reports and timelines
	Liquidity Forecast	<ul style="list-style-type: none">• Conduct funding estimate at currency level
	Pre-funding	<ul style="list-style-type: none">• Arrange funding in advance on H-1 day• Extend pre-funding or credit facilities coverage to non-HKD and H day
	E-banking and transfer Authorization	<ul style="list-style-type: none">• Proper e-banking authorization and limits, coverage include FX conversion and inter-bank transfer• Proper authorization granted to staff on duty to conduct funding transfer on H day






Risk Management

3.4 Settlement Control and Monitoring (**Contingency Plan in case of Late Payment for HCPs**)

e.g. insufficient funding is found in designated bank account on H day

Key Information

	Areas	Details
	Ability to provide proof of financial position	Sufficient authorization to allow staff on duty to provide bank balance to clearinghouse upon request
	Ability to conduct immediate funding transfer	Proper limit and authorization assigned to conduct third party account transfer (i.e. between CP's bank accounts and to HKCC bank accounts)
	Currency of obligations	Prepare to provide and transfer cash collateral other than the currency of the obligation at last resort

Important: Any failure to meeting clearing house obligations would trigger an event default and could have serious consequence on your firm



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/001/2023](#) issued on 28 Feb 2023 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:-

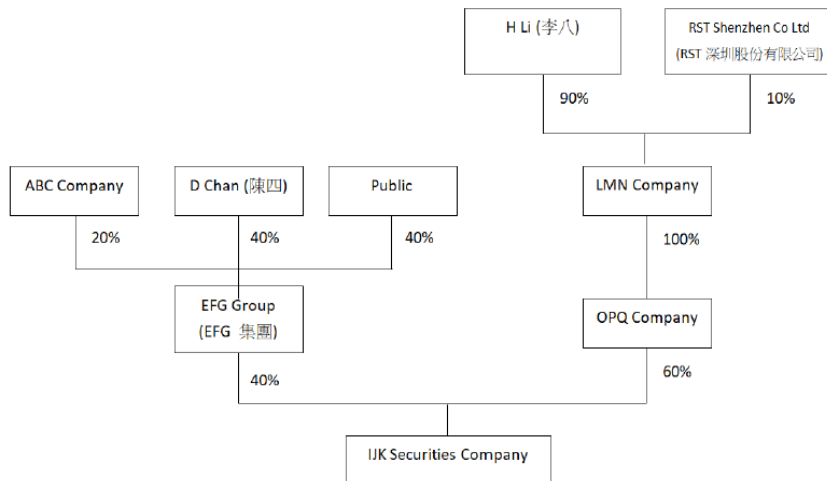
- ✓ **NCP on-boarding and termination** – on-boarding requirement and obligation/process for NCP termination
- ✓ **Trading/credit risk control and mitigation** – pre-trade and at-trade limit control, trading activity monitoring and exception authorisation
- ✓ **Default management** – NCP default and 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



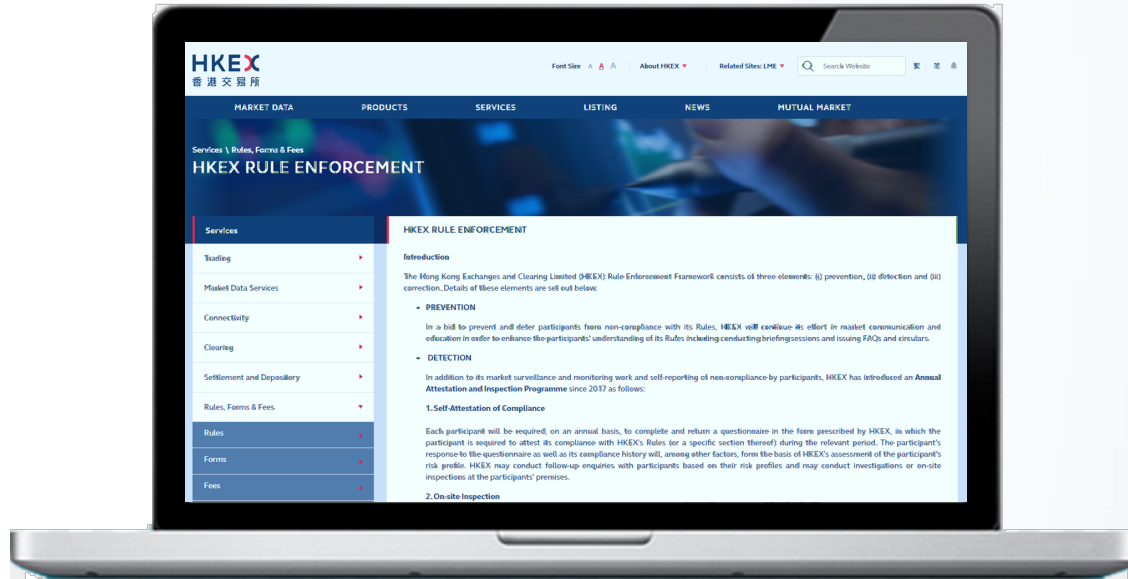
Q & A Session



HKEX Rule Enforcement Designated Website & Email Account



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



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



Appendix

Past publications on BCAN requirements

2023

- [2022 Compliance Reminder on China Connect Rules](#)

2022

- [Seminar on 2022 Annual Attestation and Inspection Programme](#)
- [Compliance Bulletin \(Issue No. 3\) – \(i\) Investor Eligibility Requirements and \(ii\) BCAN Requirements \(Ref. No. MSM/002/2022\)](#)
- [2021 Compliance Reminder on China Connect Rules](#)

2021

- [BCAN Client Type Classification for Proprietary or Principal Trading \(Ref. No. MSM/008/2021\)](#)
- [2020 Compliance Reminder on China Connect Rules](#)

2020

- [2019 Compliance Reminder on China Connect Rules](#)

