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Hong Kong Exchanges and Clearing Limited is a recognized exchange controller under the Securities and Futures Ordinance which is the controller of The Stock Exchange of Hong Kong Limited, Hong Kong Futures Exchange Limited, Hong Kong Securities Clearing Company Limited, The SEHK Options Clearing House Limited, HKFE Clearing Corporation Limited and OTC Clearing Hong Kong Limited.

通告 CIRCULAR

Subject: Compliance Bulletin (Issue No. 10) – (1) Standard Penalties on Violation of Hong Kong Investor Identification Regime (“HKIDR”) Submission Requirements, (2) Input Requirements for Securities Traded in Foreign Currencies, (3) Client Margin Requirements, and (4) Exchange Participant’s (“EP”) Responsibility to Ensure Integrity of Electronic Trading System in Use

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As part of our continuous efforts to promote transparency and a culture of compliance in our marketplace, the Exchange has prepared this Compliance Bulletin to offer the industry a better understanding of our enforcement work and regulatory expectations. It serves as a reminder on some salient points in relation to (1) standard penalties applicable to violation of the HKIDR submission requirements under the Rules of the Exchange (“**SEHK Rules**”), (2) input requirements for securities traded in foreign currencies under the SEHK Rules, (3) client margin requirements under the Rules, Regulations and Procedures of the Futures Exchange (“**HKFE Rules**”), and (4) EP’s responsibility to ensure the integrity of electronic trading system in use.

(1) Standard Penalties on Violation of HKIDR Submission Requirements under the SEHK Rules

Reference is made to the circular published on 3 March 2023 (Ref. No.: [LSD/016/2023](#)) which requested EPs to note, amongst other things, the following Summary Fine Offences pursuant to Part II of the Disciplinary Procedures and the Schedule of Penalties of the SEHK Rules:

Relevant Rule Violation Falling under Summary Fine Offences
<p>Failure of a Relevant Regulated Intermediary, which is an EP, to comply with the requirements under SEHK Rule 538A, as the case may be, within a 12-month rolling period:</p> <ul style="list-style-type: none">▪ Rules 538A(3) and 538A(4) – Submit BCAN-CID Mapping File to the Exchange in such manner and by the relevant prescribed deadlines (T-1 day or T day as the case may be);▪ Rule 538A(5) – Ensure accurate and up-to-date information in the BCAN-CID Mapping File especially the name and identity document number which form client’s CID;▪ Rule 538A(6)(d) – Report each order underlying an executed aggregated order (on-exchange or off-exchange) in the prescribed form on or before T+3 day; and▪ Rule 538A(8) – Obtain all necessary authorizations and written or other express consents from each existing and new individual client before inputting any buy orders for such client on T-day.
Schedule of Penalties
<p><u>First offence</u> Issuance of a warning letter</p>
<p><u>Second offence</u> An imposition of a fine of HK\$25,000</p>
<p><u>Third offence</u> An imposition of a fine of HK\$50,000</p>
<p><u>Any subsequent offence</u> To be treated as an offence to be dealt with by hearings in accordance with the Procedures for Offences To Be Dealt With By Hearings</p>

(2) Input Requirements for Securities Traded in Foreign Currencies under SEHK Rule 524

Relevant Rules
<p>SEHK Rules</p> <ul style="list-style-type: none"> ○ Chapter 5 – Trading <ul style="list-style-type: none"> ▪ Rule 524 – Securities Traded in Foreign Currencies ○ Third Schedule – Currencies Table
Key Requirement and Deficiency Noted
<p>EPs, when inputting orders or transactions relating to securities traded in foreign currencies into the Orion Trading Platform – Securities Market (the “System”), shall take note of the ‘unit’ of each currency as prescribed in the Currencies Table in the Third Schedule to the SEHK Rules. The ‘unit’ indicates the number by which the price of the issue of securities has to be divided before inputting into the System.</p> <p>There is a recent case where an EP has overlooked the input requirements for securities traded in foreign currencies. As a consequence, incorrect transaction details were inputted into the System.</p>
Illustrative Example
<p>The Exchange sets out below an illustrative example to demonstrate the expected input for orders or transactions relating to securities traded in foreign currencies by EP(s):</p> <p>Based on the Currencies Table in the Third Schedule of the SEHK Rules, the unit of Japanese Yen is ‘1,000’. Therefore, the price of an issue of securities in Japanese Yen at 10,000 Yen should be entered into the System as 10 Yen.</p>

(3) Client Margin Requirements – Notification Requirements under HKFE Rule 619

Relevant requirements
<p>i. HKFE Rules</p> <ul style="list-style-type: none"> ○ Chapter VI – Exchange Participants and Their Clients <ul style="list-style-type: none"> ▪ Rule 619 – Monitoring Margin Calls, Demands for Variation Adjustment and Physical Delivery Contracts Delivery Obligations <p>ii. Circulars</p> <ul style="list-style-type: none"> ○ 2018 Annual Attestation and Inspection Programme – Compliance Reminder on Client Margin Requirements (PDF) ○ 2020 Annual Attestation and Inspection Programme – Compliance Reminder on Client Margin Requirements (PDF)
Key Requirements and Common Misunderstandings of the Notification Requirements
<p>Under HKFE Rule 619, EPs are obliged to monitor continuously their Clients' ability to meet any margin calls and demands for variation adjustment, and notify HKFE in the event that any Client has failed to meet two or more successive margin calls or demands for variation adjustment which in aggregate exceed HK\$150,000.</p> <p>Below are some of the misunderstandings on the applicable reporting requirements where EPs are unaware that:</p> <ul style="list-style-type: none"> (i) They are still required to notify HKFE of their Clients' successive failure to meet margin calls, even if the positions of the Clients have subsequently been liquidated. (ii) Apart from the initial notification, they are required to provide continuous notification to HKFE on each Trading Day for subsequent failures by the relevant Client to meet margin calls, until the outstanding amount of margin calls or demands for variation adjustment, which in aggregate falls below HK\$150,000. <p>As a reminder, EPs shall have proper written policies and procedures in place to ensure effective monitoring and control pertaining to client margin requirements, including but not limited to specifying the timeframe for margin call issuance and settlement deadlines in the policies and procedures, as well as clear designation of responsible personnel to ensure the fulfilment of the notification requirement under HKFE Rule 619.</p> <p>In addition, EPs should provide adequate and appropriate training to staff involved in the relevant business activities, both initially and on an ongoing basis to ensure they have sufficient knowledge and understanding on the client margin requirements.</p>

(4) EP's Responsibility to Ensure Integrity of Electronic Trading System in Use

Relevant Requirements
<p>i. SEHK Rules</p> <ul style="list-style-type: none">○ Chapter 6 – Professional Conduct<ul style="list-style-type: none">▪ Rule 612 – <i>“A Participant shall put in place adequate and effective internal policies, guidelines and/or control procedures to protect its operations, its clients, and other Participants from any loss (financially or otherwise) arising from theft, fraud, and other dishonest acts, professional misconduct or omissions and to ensure its compliance with the HKSCC Rules, the Clearing Rules, the Options Trading Rules, the Ordinance and these Rules.”</i> <p>ii. HKFE Rules</p> <ul style="list-style-type: none">○ Chapter V – General Obligations of Exchange Participants<ul style="list-style-type: none">▪ Rule 522B – <i>“In accordance with paragraph 4.3 of the SFC Code of Conduct, each EP should have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its Clients and other EPs from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.”</i> <p>iii. SFC Code of Conduct</p> <ul style="list-style-type: none">○ Paragraph 18 – Electronic Trading<ul style="list-style-type: none">▪ Paragraph 18.4 Management and supervision – <i>“A licensed or registered person should effectively manage and adequately supervise the design, development, deployment and operation of the electronic trading system it uses or provides to clients for use, as may be appropriate in the circumstances.”</i>▪ Paragraph 18.5 Adequacy of system – <i>“A licensed or registered person should ensure the integrity of the electronic trading system it uses or provides to clients for use, as may be appropriate in the circumstances, including the system’s reliability, security and capacity, and have appropriate contingency measures in place.”</i>

Observations from Recent Non-compliance Incidents

During our recent inquiries into SEHK Rules related non-compliance incidents¹, some EPs stated that they have experienced system issues following security patch release, system modifications, new features or enhancements introduced by third-party system vendor. While EPs generally acknowledged their obligations to maintain integrity of their trading system and have taken immediate remedial actions by enhancing their testing strategies during User-Acceptance-Test (“UAT”), it is observed that a few of them failed to recognize their responsibilities to manage and supervise their vendor, and the need to have adequate and effective internal control measures in place to preserve the integrity of their trading system in use to ensure compliance with the relevant requirements at all times. The Exchange is concerned that these EPs’ misperception about their roles and responsibilities in particular when handling system modification or upgrade would make them more susceptible to non-compliance of the Exchange rules or other relevant regulatory requirements.

Reminder to EPs

The Exchange would like to remind EPs of the followings:

- (i) All system modifications or upgrades should be deployed with proper control and supervision process, regardless of whether those changes are introduced by third-party system vendor or created by the EP itself. Where changes involve vendor-developed systems, EPs should apply effective management and adequate supervision to their vendors throughout the process.
- (ii) Due care and diligence should be exercised to maintain an effective system validation. In particular, UAT should be conducted with adequate and effective coverage and scope to ensure the reliability, security and capacity of the trading system it uses or provides to clients for use.
- (iii) Appropriate contingency measures for unexpected system failure should be in place to avoid jeopardizing the operation of a fair and orderly market.
- (iv) All relevant system controls (regardless of whether they are related to manual trade reporting as unveiled in the recent non-compliance incidents) are functioning as designed to ensure compliance with all applicable rules and regulatory requirements at all times.

¹ These non-compliance incidents involve delays and errors in the reporting of manual trades to the Exchange caused by database performance or configuration issues, and BCAN tagging errors in which the trading system has overridden the properly assigned and tagged BCAN with a reserved value “1” on all sell orders sending to the Exchange.

The Exchange would like to point out that the requirements and examples set out in this Compliance Bulletin are by no means exhaustive. They are intended for general reference only and should not be construed as legal advice. All liabilities with respect to actions taken or not taken based on the contents of this circular are hereby expressly disclaimed. EPs should always take into consideration their own circumstances to ensure full compliance with the relevant rules and requirements and seek their own professional advice on their specific situation where appropriate.

EPs are strongly advised to review their current set up and implement appropriate measures to strengthen their controls, and where necessary, take appropriate actions to address any potential rule breaches or deficiencies.

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.

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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.