

## **Appendix 3**

### **Compliance Reminder on China Connect Rules**

*(Applicable to China Connect Exchange Participants and Trade-through Exchange Participants of SEHK only)*

China Connect Exchange Participants (“CCEPs”) and Trade-through Exchange Participants (“TTEPs”) are required to comply with the relevant rules and regulations as stipulated in the Rules of the Exchange (“SEHK Rules”), including without limitation to Chapters 5, 14, 14A and 14B at all times, regarding to the trading of China Connect Securities.

In the 2018 Annual Attestation and Inspection Programme, some CCEPs and TTEPs were found deficient in the following areas:-

#### **1. Trade-through Exchange Participants**

- ***Failure to submit a declaration to the Exchange before conducting trading in China Connect Securities for the account of their clients.***

Pursuant to SEHK Rule 590 and as stated in paragraph 1.43 of the [Stock Connect Frequently Asked Questions](#) (“FAQs”), 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 CCEPs for the account of their clients as TTEPs as referred to in SEHK Rule 590(2). TTEPs are required to provide a declaration to the Exchange confirming such matters as the Exchange may require, including the EPs’ awareness of and ability and undertaking to comply with applicable laws in respect of the trading of China Connect Securities. Among other things, their back office systems must have the capability of conducting pre-trade checking, client agreements must be amended to allow for Northbound trading and appropriate arrangements must be made to ensure that their clients understand the risks of investing in China Connect Securities, etc. TTEPs are required to abide by the rules governing Northbound trading under SEHK Rules as if they were CCEPs. The Exchange has published the names of such TTEPs on the HKEX website.

#### **2. Client Agreement and Risk Disclosure**

- ***Insufficient provisions in client agreements or other account opening documents to ensure clients acknowledged and are aware of the differences in the restrictions, requirements, conditions and risk associated with Northbound trading of China Connect Securities, as well as the scope of services available to clients.***
- ***Failure to communicate clearly the scope of services provided to the clients.*** We noted that some CCEPs included in the client agreement certain provisions and clauses related to services which they did not provide to the clients in the client agreement.

To comply with the requirements under and without limitation to SEHK Rules 14A10, 14B10 and 14B06(16) to (18), and 1.26 and 1.53 of the FAQ, CCEPs and TTEPs should include in the client agreement sufficient provisions covering Northbound trading of China Connect Securities including the risks involved, and clearly communicate the scope of services provided to the clients.

### 3. Pre-trade Controls and Post-trade Monitoring

- ***Lack of effective and sufficient pre-trade controls and post-trade monitoring on their Northbound trading activities.***

CCEPs and TTEPs are reminded to observe and comply with SEHK Rules 14A06(4), 14B06(5), 14A06(9)-(10), 14B06(11)-(12), 14A17, 14B17, 1421(2), 1428(1), 1432 and 1433 in particular. To these ends, CCEPs and TTEPs should put in place reasonable and necessary controls that can effectively prevent day trading, overselling of sellable inventory positions, misflagging of short selling orders and mischievous behavior towards the use of the Northbound quota and ensure compliance with all applicable laws with regard to the Northbound trading of China Connect Securities including but not limited to laws and regulations prohibiting insider dealing, market manipulation, price rigging, false trading or the creation of a false or misleading appearance of active trading on any China Connect Securities.

### 4. Margin Trading

- ***Providing funds or securities margin financing arrangement to their clients on a portfolio basis.*** We noted that some CCEPs provided securities margin financing arrangement to their clients, by reference to the aggregated collateral values of all securities held in their portfolio, to purchase securities including China Connect Securities which may **not** be confined to those included in the List of Eligible SSE/SZSE Securities for Margin Trading.

Under SEHK Rules 14A15 and 14B15, CCEPs and TTEPs shall ensure that Margin Trading is confined to those China Connect Securities that are included in the List of Eligible SSE/SZSE Securities for Margin Trading published by the Exchange from time to time.

### 5. Foreign Investor Shareholding Monitoring

- ***Failure to put in place monitoring arrangements to ensure clients' compliance with foreign investors' shareholding restrictions and disclosure obligations for China Connect Securities.*** Various CCEPs held the mistaken belief that they were not obliged to monitor their client's holding in China Connect Securities as they may not be the client's sole custodian.

The Exchange wishes to draw CCEPs' and TTEPs' attention to SEHK Rules 14A08, 14B08, 14A09 and 14B09, which require CCEPs and TTEPs to put appropriate monitoring arrangements in place to comply with these rules and alert their clients to comply with the 5% shareholding disclosure requirements and the 10% individual shareholding limit for China Connect Securities.

## 6. Trading of ChiNext Shares

- **Failure to put in place adequate controls to ensure that only Institutional Professional Investors (“IPIs”) are allowed to buy ChiNext shares.** In particular, we noted that some CCEPs failed to conduct (i) regular review on the IPI status of their clients, and/or (ii) regular and appropriate post trade review which covers all clients including the underlying clients of intermediary clients.

The Exchange is of the view that effective controls on pre-trade and post-trade level are essential to ensure compliance with the investor eligibility requirement for trading in ChiNext shares under SEHK Rules 14B06(16) to (18).

## 7. Off-exchange Trades or Transfers

- **Inadequate policies, procedures and controls to ensure that off-exchange trades or transfers are prohibited.** In particular, we noted that some CCEPs failed to establish written policies and procedures in relation to handling of off-exchange trades or transfers for the purposes prescribed under SEHK Rules 14A12 and 14B12.

To comply with the requirements under SEHK Rules 14A12 and 14B12, CCEPs and TTEPs shall put in place adequate controls to prevent or detect non-trade transfers or to handle those permitted under SEHK Rules 14A12(2) and 14B12(2).

## 8. Staff Training

- **Inadequate staff training.** Some EPs did not provide mandatory and product-specific training for staff involved in the business activity in the Priority Areas, and merely relied on on-the-job training through sharing and coaching by senior staff members.

To foster a culture of compliance, the Exchange wishes to remind EPs that they should provide staff with adequate and appropriate training both initially and on an ongoing basis.

## 9. Policies and Procedures

- **Inadequate and lack of regular review on policies and procedures.** Some EPs did not establish proper written policies and procedures governing the business activity in the Priority Areas while some EPs did not conduct regular review even though such policies and procedures were in place.

The Exchange wishes to remind EPs that adequate 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.