

Appendix 1

Compliance Reminder on China Connect Rules

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

China Connect Exchange Participants (“**CCEPs**”) and Trade-through Exchange Participants (“**TTEPs**”) are required to at all times, comply with the relevant rules and regulations regarding the trading of China Connect Securities as stipulated in the Rules of the Exchange (“**SEHK Rules**”), including but not limited to Chapters 5, 14, 14A and 14B.

In the 2023 Annual Attestation and Inspection Programme, some CCEPs and TTEPs were found to be deficient in the following areas:

1. Broker-to-Client Assigned Number (“BCAN”) Requirements

▪ ***Multiple BCANs assigned for the same client***

- (i) Clerical mistakes during client onboarding process, staff oversight in handling client profile updates, inaccurate input of client data, and deficiencies in BCAN generation process and system design were common reasons that led to multiple BCANs being generated and assigned to the same client.
- (ii) Misinterpretation of rules resulted in assignment of different BCANs to segregated portfolios under the same fund company sharing the same company registration number.

▪ ***Inaccurate CID and BCAN client type provided in the BCAN-CID Mapping File***

- (i) Due to insufficient understanding of the classification requirement and lack of / ineffective maker-checker process for client data input, some TTEPs mistakenly assigned the house accounts of their corporate clients and/or discretionary account under *Proprietary or Principal Trading* (Type 5), which is in fact only intended for the house accounts of the CCEP or TTEP or that of their affiliates.
- (ii) Due to human errors and misunderstanding of the BCAN requirements, some CCEPs mistakenly assigned their house accounts under *Legal Entity – Fund* (Type 3), which is in fact only intended for fund clients.
- (iii) Due to human errors, insufficient understanding or misunderstanding of the BCAN requirements and deficiencies in system design, some CCEPs mistakenly assigned their own house account and/or their affiliates’ house account under *Legal Entity – Fund managers and others* (Type 4), which is in fact only intended for fund managers or other corporate clients.

- (iv) Due to legacy issue, human error, insufficient understanding of the BCAN requirements and internal policy prohibiting activation of China Connect Service for client trading in agency capacity, some CCEPs mistakenly assigned corporate clients and joint accounts under *Individual* (Type 1) which is in fact only intended for individual clients.
 - (v) Some CCEPs failed to assign the corresponding client type for its or its affiliate's fund or fund manager clients, and wrongly classified fund clients under *Legal Entity – Fund managers and others* (Type 4), or fund managers or other corporate clients under *Legal Entity – Fund* (Type 3).
 - (vi) Due to insufficient understanding or misunderstanding of the BCAN requirements, clerical mistakes, staff oversight, absence of diligent review of BCAN-CID Mapping File by CCEPs' affiliate, system error and/or inadequate User Acceptance Test (UAT) performed during system upgrade, some CCEPs and TTEPs failed to provide the exact CID as shown on clients' official identity documents, including but not limited to the client name, identity number, ID type, country/ region of issuance. Some CCEPs mistakenly included *alias* of client name and/or internal reference, or deleted existing BCAN of client in the BCAN-CID Mapping File. In addition, some CCEPs and TTEPs incorrectly used the Business Registration Certificate as identity documents instead of the Certificate of Incorporation or other official incorporation documents / Legal Entities Identifiers (LEI).
 - (vii) Due to system limitation, some CCEPs failed to remove the obsolete data from the BCAN-CID Mapping File.
- ***Insufficient controls / arrangements to ensure BCAN-CID Mapping File data accuracy***
- (i) ***No regular review.*** Some CCEPs and TTEPs did not conduct any regular review of the data in the BCAN-CID Mapping File and failed to detect inaccurate client type assignments and/or incorrect CID input.
 - (ii) ***Absence or ineffective maker-checker process for client data input.*** Some TTEPs did not put in place maker-checker process to ensure client data is accurately inputted into their internal systems. While some CCEPs and TTEPs represented that they had put in place such maker-checker process and/or have such process documented in their written policies and procedures, there was no audit trail to support their representation, or the audit trail did not show a clear segregation of marker-checker duties. The absence of or an ineffective maker-checker control could contribute to inaccurate client type assignments and/or incorrect CID input.
 - (iii) ***Lack of adequate control over data accuracy regarding online account opening and/or China Connect Service activation.*** Some CCEPs and/or their affiliates accept both offline and online application for account opening and/or

China Connect Service activation by their clients. While maker-checker process was put in place to ensure accuracy of client data provided offline, inadequate control was put in place to ensure accuracy of client data provided online.

- (iv) ***Lack of adequate control over data accuracy regarding BCAN assigned by its affiliate to underlying clients.*** Some CCEPs on-boarded their non-EP affiliates as their clients where BCANs were assigned to the affiliates' underlying clients. However, they did not put in place adequate control to ensure data accuracy on those BCANs concerned, leaving the data inaccuracy issue at the affiliates level undetected.

- ***Insufficient controls / arrangements to ensure BCAN confidentiality and BCAN access granted on a need-to-know basis only***

Some CCEPs unnecessarily displayed BCANs in their internal systems and some CCEP/TTEPs unnecessarily granted BCAN access to Responsible Officers, dealers, compliance staff, settlement staff, finance staff, licensed representatives or account executives without proper or adequate justifications provided. These CCEPs and TTEPs are considered failing to ensure that the use of and accessibility to BCANs are strictly restricted on a need-to-know basis.

- ***BCAN Consent***

Some CCEPs' client consent did not adequately cover the collection, storage, use, disclosure and transfer of personal data in relation client's BCAN and CID for the purposes as set out in SEHK Rule 1425A(5).

- ***Insufficient controls to ensure correct BCAN tagging***

Human errors in processing high-touch orders and inadequate written policies and procedures have led to incorrect BCAN tagging.

▪ ***Incorrect BCAN assignment for TTEPs***

Due to misunderstanding of the BCAN requirement or clerical mistake, a single BCAN, instead of a BCAN range was assigned to a TTEP. In fact, a CCEP executing for TTEPs should set aside BCAN ranges for each of its TTEPs for them to assign to their clients so that BCANs used by the CCEP will not overlap with those used by its TTEPs. The BCANs of a TTEP for proprietary trading should also be within the same BCAN range designated by its executing CCEP.

▪ ***Failure to remove CHN BCANs after transition period ended***

Due to miscommunication between CCEPs and system vendors, some CCEPs misunderstood the workflow and overlooked the deadline for deleting all BCANs with “CHN” as the country/ region of issuance from the BCAN-CID Mapping File.

CCEPs and TTEPs are reminded to observe and comply with the BCAN requirements as set out in SEHK Rule 1425A, and to refer to various guidance, including but not limited to the [Northbound Investor ID Model FAQ](#), [Guidance Notes on BCAN-CID Mapping File](#), [BCAN – CID Mapping File Data Record Examples](#) and [Northbound Trading Investor ID Model - System File Interface Specification](#).

In this regard, CCEPs and TTEPs should put in place necessary controls and arrangements, and regularly assess their effectiveness, such that they can, amongst other things, (i) assign unique BCAN to each of their Northbound trading clients, (ii) ensure BCAN client type and CID submitted to the Exchange is accurate and up to date, (iii) keep BCANs strictly confidential, (iv) ensure BCAN assignment is correct, and (v) ensure BCAN consent with adequate coverage is obtained from clients before proceeding with order placing. In addition, CCEPs and TTEPs are reminded that once a BCAN was assigned to a client, it shall not be changed and shall not be reused for other clients, unless with the prior written approval from the Exchange. Comprehensive guidelines should be in place to ensure that the controls and arrangements are being implemented as designed and in a consistent manner. Furthermore, adequate training should be provided to staff involved in BCAN-related process on a regular and on-going basis.

The Exchange wishes to draw CCEP’s and TTEP’s attention to some of the good practices that we observed during the onsite inspection:

- (a) In order to avoid treating a client with multiple accounts as different clients, and inadvertently assigning that client with multiple BCANs as a result, some CCEPs/TTEPs would request the client to declare in its account opening form that he/she has not opened any account with the firm previously. Some CCEPs/TTEPs would also compare other client information (e.g. address, contact number) to identify any potential matches.
- (b) To handle multiple trading accounts setup arrangement (e.g. cash and margin accounts, master/sub-accounts, fund and fund manager accounts etc.) in a prudent

manner, some CCEPs/TTEPs assign BCANs based on the ID number for individual clients and business registration number for corporate clients, rather than on trading account level.

- (c) Some CCEPs/TTEPs conduct independent review on all client information obtained during onboarding to ensure data accuracy.
- (d) Some CCEPs/TTEPs perform regular review 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 to ensure the CIDs submitted to the Exchange are complete, accurate and up-to-date.
- (e) Adopt automation and minimize manual intervention as much as possible. Where manual procedures are involved in BCAN assignment and submission process, maker-checker mechanism is implemented with audit trail and properly documented in the written policies and procedures.

CCEPs and TTEPs are encouraged to make reference to our Compliance Bulletin (Ref. No.: [MSM/007/2023](#) and [MSM/002/2022](#)) which listed out some common deficiencies and related issues identified, and also good practices observed with respect to compliance with the relevant BCAN requirements.

2. **TTEP registration and Provision of brokerage service in China Connect Securities to CCEPs**

▪ ***TTEP registration***

When onboarding clients who are also Exchange Participants (“EPs”), some CCEPs failed to check their trading capacity to ensure that their EP clients that wish to conduct trading through the China Connect Service for the account of their clients have been registered as TTEPs.

▪ ***Provision of brokerage service in China Connect Securities to CCEPs***

- (i) Some CCEPs activated China Connect trading services for their CCEP clients without ascertaining their purposes of activating China Connect trading services at their firm.
- (ii) Pursuant to SEHK Rule 590, only a TTEP (not CCEP) is allowed to trade through a CCEP; the only exception would be for contingency purpose.

The Exchange wishes to draw EP's attention to the following:

- (a) Pursuant to SEHK Rules 590(2) and 590(4) and as stated in paragraph 1.43 of the [Stock Connect Frequently Asked Questions \("Stock Connect FAQ"\)](#), 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.
- (b) TTEPs are required to provide a declaration to the Exchange confirming such matters as the Exchange may require, including the TTEP's awareness of and the ability and undertaking to comply with the applicable laws in respect of the trading of China Connect Securities. Among other things, their 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 the SEHK Rules as if they were CCEPs. From time to time, the Exchange may publish on the HKEX website (or by such other means as it considers appropriate), a list of TTEPs who have submitted declarations to the Exchange. TTEPs must not provide instructions to a CCEP, whether directly or indirectly, to trade in China Connect Securities for the account of their clients before their names are included in such published list of TTEPs.
- (c) CCEPs should put in place adequate controls to ensure that their intermediary broker clients, who are EPs and conduct trading for their clients, must be registered as TTEPs both initially and on an on-going basis.

3. Trading of ChiNext and STAR Shares

- ***Inadequate controls to ensure accuracy of the stock code range for ChiNext and STAR shares***

Some CCEPs did not have adequate control in place to ensure the stock code range for ChiNext and STAR shares are accurate and up-to-date, but merely rely on system vendor in maintaining the stock code range.

- ***Inadequate pre-trade controls in place***

Some CCEPs did not put in place adequate pre-trade controls to block all clients / non-Institutional Professional Investors ("IPI") from trading ChiNext and STAR shares. Blocking behaviors depend on the trading limit granted to the clients. In the event that clients' ChiNext or STAR order is below the trading limit, order will be transmitted to the market for execution.

- ***Inadequate procedures and controls for a timely identification of non-compliance incident in relation to Investor Eligibility requirement***
 - (i) Some CCEPs and TTEPs relied entirely on the pre-trade system controls to block all clients / non-IPIs from trading ChiNext and STAR shares, which is considered insufficient for the purpose of timely identification of non-compliance incidents.
 - (ii) Some CCEPs and TTEPs only conducted post-trade review at direct client level but failed to cover all clients including the underlying clients of the intermediaries.
 - (iii) Some CCEPs represented that they had performed post-trade review, which, however, was not covered by adequate documentation.

The Exchange is of the view that effective controls on client onboarding, pre-trade and post-trade level are essential to ensure compliance with the investor eligibility requirements for trading in ChiNext and STAR shares respectively under SEHK Rules 14A06(13) to (15) and 14B06(16) to (18).

The Exchange wishes to draw CCEP's and TTEP's attention to a good practice we observed during the onsite inspection. We noted that some CCEPs have adopted automation to utilize ChiNext/STAR product flagging directly from the websites¹ of Shanghai and Shenzhen Stock Exchanges respectively on a daily basis to help them to ascertain whether a particular stock is listed on the ChiNext or STAR board, followed by a reconciliation conducted between the information obtained from the exchange data feeds and third party vendor on a real time basis.

CCEPs and TTEPs are also encouraged to make reference to our Compliance Bulletin (Ref. No.: [MSM/009/2023](#) and [MSM/002/2022](#)), which listed out some common deficiencies and related issues identified, and good practices observed with respect to compliance with the relevant investor eligibility requirements.

4. Margin Trading

- ***Provision of margin trading to clients for trading securities that are not included in the List of Eligible SSE / SZSE Securities for Margin Trading***

Some CCEPs provided funds to clients for trading securities that are not included in the List of Eligible SSE / SZSE Securities for Margin Trading. In some cases, CCEPs included the receivables from the sale of stocks or products in other markets (e.g. sale of Hong Kong market securities, which can only be settled on T+2) as part of clients' purchasing power and allowed them to purchase China Connect Securities (which need to be settled on T+1). In these cases, the CCEPs did not put in place any further

¹ SSE: <http://www.sse.com.cn/assortment/stock/list/share/>
SZSE: <http://www.szse.cn/market/product/stock/list/index.html>

controls to ensure the relevant clients would have sufficient cash in the account before the settlement.

- ***Inadequate pre-trade control in place***
 - (i) Some CCEPs adopt soft block to reject China Connect orders placed by their direct clients with insufficient CNY cash balance, followed by manual override after the dealer and the approver had verified that the clients have sufficient cash in other currency accounts, or after taking into account various qualitative factors such as the market condition, client's background and transaction history. However, there was inadequate documentation to record details of the verification process.
 - (ii) Some CCEPs grant credit limit to its cash client for trading China Connect Securities. If any of these client uses the credit limit granted and places orders to trade any China Connect Securities which are not included in the List of Eligible SSZ/SZSE Securities for Margin Trading, it may result in violation of the relevant rules and requirement.
 - (iii) Some CCEPs only upload the respective List of Eligible SSE and SZSE Securities for Margin Trading to update their trading system on a monthly basis, instead of daily or ad-hoc basis. This way of handling is not considered effective as it may not be able to block margin trading for non-eligible SSE and SZSE Securities in a timely or accurate manner.

- ***Inadequate procedures and controls for a timely identification of non-compliance incident in relation to Margin Trading***
 - (i) Some CCEPs and TTEPs relied entirely on the pre-trade system controls or checking to block clients from trading all / non-eligible China Connect Securities on margin, which is considered insufficient for the purpose of timely identification of non-compliance incidents.
 - (ii) Some CCEPs represented that they have performed post-trade review but there was no documentation to support the conducting of such review.
 - (iii) Some CCEPs put in place post-trade controls on its direct clients to ensure compliance with the margin trading requirements but the same control was not equally applied to their affiliates. While they would monitor if their affiliates had traded China Connect Securities and had transferred sufficient CNY for settlement, they did not put in place adequate post-trade controls, for example actively follow-up or seek confirmation from their affiliates, to ensure the affiliates had transferred sufficient CNY to the CCEP in-time for settlement.

CCEPs and TTEPs are reminded of the need to strengthen their controls on and to ensure compliance with the respective requirements as stipulated under SEHK Rules 14A15 and 14B15 as well as the relevant circulars.

5. Client Agreement and Risk Disclosure

▪ ***Insufficient coverage in client agreements or other account opening documents***

Some CCEPs failed to include sufficient provisions, clauses or declarations to ensure clients have acknowledged and are aware of the restrictions, requirements, conditions and risks associated with Northbound trading of China Connect Securities, as well as the scope of services available to clients.

▪ ***Insufficient clarity on the scope of services provided to clients***

We noted that some CCEPs, which provide Margin Trading, Stock Borrowing and Lending and Short Selling services for local or overseas securities but not for China Connect Securities, failed to clearly communicate to their clients through the client agreement or other supplementary notification specifying that such services are not available for China Connect Securities. Some TTEPs represented that they had verbally communicated the scope of services provided to clients no documentation is available to support that such communication has indeed taken place.

To comply with the requirements respectively under SEHK Rules 14A10, 14B10, 14A06(13) to (15) and 14B06(16) to (18), and also paragraphs 1.26 and 1.53 of the Stock Connect FAQs, 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 their clients.

6. Odd Lot Transactions

▪ ***Inadequate controls on sell order relating to the sale of all, and not part, of the China Connect odd lots held***

Some CCEPs failed to implement effective pre-trade control in all of their trading systems to block partial odd lot selling.

Under SEHK Rules 14A06(3) and 14B06(4), CCEPs and TTEPs shall put in place reasonable and necessary system and controls to ensure that the sale of odd lot relates to the sale of all, and not part, of the odd lots held in respect of a China Connect Security for a CCEP or TTEP or for a client (as the case may be).

7. Policies and Procedures

- ***Inadequate policies and procedures, and lack of regular reviews***

- (i) ***BCAN requirements.*** Some CCEPs/TTEPs failed to establish adequate written policies and procedures in relation to the handling of BCAN assignment for the purpose of ensuring compliance with the BCAN requirements under SEHK Rule 1425A.
- (ii) ***TTEP registration.*** The written policies and procedures of some CCEPs did not contain adequate details and guidance relating to the provision of brokerage services to EPs for the purpose of ensuring compliance with the TTEP registration requirement under SEHK Rule 590.
- (iii) ***ChiNext and STAR trading.*** The written policies and procedures of some CCEPs did not contain adequate details and guidance in relation to (i) regular review of the stock code range to ensure such range is accurate and up-to-date, (ii) regular and appropriate post-trade review to cover all clients, and/or (iii) handling of intermediary clients with dual capacity, for the purpose of ensuring compliance with the investor eligibility requirement for trading in ChiNext and STAR shares respectively under SEHK Rules 14A06(13) to (15) and 14B06(16) to (18).
- (iv) ***Margin Trading.*** The written policies and procedures of some CCEPs did not contain adequate details and guidance in relation to (i) pre-trade controls and/or (ii) post-trade review for the purpose of ensuring compliance with the margin trading requirements respectively under SEHK Rules 14A15 and 14B15.
- (v) ***Escalation procedures and operational risk management framework.*** The written policies and procedures of some CCEPs/TTEPs did not contain adequate details and guidance relation to (i) escalation procedures and/or (ii) operational risk management framework for the purpose of implementing corrective and preventive measures.
- (vi) ***Non-trade transfer.*** The written policies and procedures of some CCEPs did not contain adequate details and guidance relation to the handling of non-trade transfer for the purpose of ensuring compliance with the requirements respectively under SEHK Rules 14A12 and 14B12.

Non-comprehensive policies and procedures may pose compliance risk as well as operational risk on the participants. The Exchange wishes to remind CCEPs and TTEPs of the need to establish and maintain comprehensive policies and procedures to ensure compliance with all relevant rules and requirements. Regular review and revision should also be conducted to ensure they are consistent, effective and up-to-date.

8. Staff Training

- ***Inadequate staff training***

Some CCEPs and TTEPs did not provide adequate and product-specific training for staff involved in the business activities of the Priority Areas, but 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 CCEPs and TTEPs that they should provide their staff with adequate and appropriate training both initially and on an on-going basis.