

**Appendix 2**

**Compliance Reminder on Hong Kong Investor Identification Regime Requirements**

*(Applicable to SEHK Participants)*

SEHK Participants (“EPs”) are required to at all times, comply with the relevant rules and regulations as stipulated in the Rules of the Exchange (“SEHK Rules”), including but not limited to the requirements applicable to Relevant Regulated Intermediary (“RRI”) under the Hong Kong Investor Identification Regime (“HKIDR”) as specified in SEHK Rule 538A.

In the 2024 Annual Attestation and Inspection Programme, some EPs were found to be deficient in the following areas:

**1. Broker-to-Client Assigned Number (“BCAN”) and Client Identification Data (“CID”) Mapping File Submission Requirement (SEHK Rules 538A(3) and 538A(4))**

▪ ***Failure to submit the BCAN-CID Mapping File by the prescribed timeframe***

Existing clients – on or before T-1 day

- (i) Due to inadvertent human error, BCANs assigned to existing clients were removed from the system and were not included in the BCAN-CID Mapping File submitted to the Exchange on or before T-1 day.
- (ii) Due to system defects occurred during the compilation process of the BCAN-CID Mapping File, some EPs failed to capture all BCANs assigned in the system and resulted in incomplete records submitted to the Exchange on T-1 day.
- (iii) Due to incorrect system configuration, the trading system failed to prevent existing clients from placing orders on the same day when their BCANs were submitted to the Exchange.

New or inactive clients – on T day

- (iv) Due to staff oversight during the account re-activation process for dormant accounts, the BCANs used for order tagging were not submitted to the Exchange on T day.

- (v) Due to misunderstanding of the BCAN requirements, a BCAN originally assigned to a newly onboarded client was deleted for the purpose of rectifying a client type error. Without noticing that such BCAN had already been used for trading on the same day, the EP wrongly assigned a new BCAN to that client and submitted the new BCAN instead of the original one in the BCAN-CID Mapping File submitted to the Exchange on T day.
- (vi) Due to inappropriate scheduling of the BCAN-CID Mapping File submission process, new clients onboarded after the T day submission timeline were not included in the BCAN-CID Mapping File submitted to the Exchange on the same day.

**2. Accurate and Up-to-date Information in the BCAN-CID Mapping File (SEHK Rule 538A(5))**

▪ ***Inaccurate CID***

- (i) Due to inadvertent human errors, staff oversight, misunderstanding of the relevant requirements, absence of maker-checker mechanism to check the CID information and/or system bugs/limitations, some EPs failed to provide the exact CID as shown on clients' official identity documents, including but not limited to the client's full name, identity document ("**ID**") number, ID type and ID issuing country or jurisdiction. Specifically,

**Name** – Some EPs have mistakenly included internal reference in the client's name and/or the names contain typographical error.

**ID Number** – Some EPs did not provide the exact ID number such as characters, numbers and symbols (e.g. brackets) as shown on the ID document. In some cases, the ID number does not match with the ID provided.

**ID Type** – Some EPs provided incorrect ID type and/or failed to follow the waterfall requirements governing the collection of CID.

**ID issuing country or jurisdiction** – In some instances, the information does not correspond to the ID provided.

▪ ***Incorrect client type classification***

A number of EPs were noted to have assigned wrong client type to their clients due to various root causes:

- (ii) Due to manual input error, some EPs mistakenly assigned their corporate clients as *Individual* (Type 1), which is intended for individual clients only.

- (iii) Due to misunderstanding of the client type classification requirements and staff oversight, some EPs mistakenly assigned their corporate clients under *Funds* (Type 3), which is only intended for fund clients, or under *Legal Entity – Fund managers* (Type 4) which is intended for fund manager clients only.
- (iv) Some EPs were found to have *by default* assigned the same client type to all clients, based on their assumptions or understanding of the firm’s clientele without implementing proper procedures to review the accuracy of the assigned client types or to verify whether their assumptions or understanding remained valid.
- (v) Due to misunderstanding of the client type classification requirement, staff oversight and manual input error, some EPs mistakenly assigned the individual clients, house accounts of their corporate clients and/or discretionary accounts managed by the EP under *Proprietary Trading* (Type 5), which is intended for RRI’s own (but not its clients’ nor affiliates’) proprietary trading account only.
- (vi) Due to misunderstanding of the client type classification requirement, staff oversight and inadvertent human errors, some EPs mistakenly assigned fund, fund manager clients, and/or a RRI’s own proprietary trading account under *Legal Entity - Others* (Type 6). This category is intended for legal entities not classified under other applicable types only.

▪ ***Incomplete / Not up-to-date information***

- (vii) Due to system issues and staff oversight, some EPs submitted incomplete BCAN-CID Mapping Files to the Exchange. Upon identifying the issue, the EPs did not have sufficient time to resubmit the corrected file within the prescribed timeframe.
- (viii) Due to staff oversight and failure to establish adequate policies and procedures, some EPs did not remove obsolete data for clients that have already closed their trading accounts from the BCAN-CID Mapping File.

▪ ***Inadequate control arrangements to ensure BCAN-CID Mapping File accuracy***

- (ix) ***Absence of maker-checker process on manual data input.*** Some EPs did not put in place a maker-checker mechanism to ensure accurate input of clients’ IDs into their internal systems for preparation of the BCAN-CID Mapping File.
- (x) ***Absence of regular review.*** Some EPs did not conduct any regular review of the information in the BCAN-CID Mapping File resulting in a failure to detect incorrect client type assignments and/or inaccurate CID input.

- (xi) **Absence of post-submission controls.** Some EPs did not implement appropriate controls, such as reviewing the Response File, Result File and Full Image File after submitting the BCAN-CID Mapping File to the Exchange to ensure the submitted BCANs are free of formatting errors and that all entries were successfully processed and accepted by the Exchange.

### 3. No Change of BCAN (SEHK Rule 538A(5))

- **Improper handling of clerical mistakes.** To rectify clerical mistakes, such as wrong selection of client account type or accidental deletion of a client BCAN in the internal system, some EPs inadvertently created a new BCAN for the client. This amounted to a failure to ensure the requirement that the BCANs, once assigned to its clients, will not be changed.

### 4. Reporting of Off-Exchange Trade BCAN (Buy-Side) (SEHK Rule 538A(6)(c))

- **Failure to implement necessary controls prior to the launch of HKIDR**
  - (i) Due to system limitations and internal oversight of the reporting requirement since the launch of HKIDR, the necessary controls and system changes were not implemented to fulfill the buy-side BCAN reporting obligation as the buying EP in an off-exchange trade.
- **Failure to provide BCAN of buy-side clients within the prescribed timeframe**
  - (ii) Due to staff oversight and/or misunderstanding of the system behavior which automated all buy-side BCAN reporting, some EPs did not submit the <Off-exchange Trade BCAN (Buy-Side) Report> to the Exchange after the conclusion of the transaction.
  - (iii) Due to inadvertent human error in the preparation of <Off-Exchange Trade BCAN (Buy-Side) Report>, some EPs failed to submit the buy-side BCAN by T day.
- **Failure to submit the report with accurate data and in a valid format**
  - (iv) Some EPs did not realize their reports were rejected by the Exchange due to input errors. Such situation was left unnoticed because they had not implemented any controls such as reviewing the Response File and/or Result File to ensure reports were error-free and accepted by the Exchange.

5. **Aggregated Order Tagging and Reporting** (*SEHK Rule 538A(6)(d)*)

- ***Incorrect usage of reserved BCAN value “2”***
  - (i) Due to clerical mistakes and misunderstanding of system behavior, some EPs have tagged the reserved BCAN value “2” to orders that in fact are not an aggregated order.
  
- ***Failure to report the underlying BCANs of the executed aggregated order on or before T+3 day***
  - (ii) Due to miscommunications between internal teams and/or staff oversight, the submission of the <Aggregated Transaction Report> was omitted.
  
- ***Mismatch between the total reported quantity and the executed aggregated orders***
  - (iii) Due to staff oversight, wrong data input in the reporting form or incorrect system logic leading to the failure in capturing all reportable aggregated transactions tagged with reserved BCAN value “2”, some EPs under-reported the underlying orders of the executed aggregated orders on or before T+3 day.
  - (iv) Some EPs were noted to have over-reported the underlying orders of the executed aggregated orders due to misunderstanding of the reporting requirements, clerical mistakes in quantity input, staff oversight, capturing non-aggregated orders in the reporting attributed to incorrect BCAN tagging or wrong system logic in the generation of the <Aggregated Transaction Report>.
  
- ***Failure to submit the report with accurate data and in a valid format***
  - (v) Some EPs did not realize their reports were rejected by the Exchange due to input errors. Such situation was left unnoticed because they had not implemented any controls such as reviewing the Response File and/or Result File to ensure reports were error-free and accepted by the Exchange.

**6. BCAN Tagging and Reporting of BCAN Error (SEHK Rule 538A(6)(f) & Rule 538A(7)(a))**

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

- (i) Due to manual input errors, inadvertent human mistakes in account selection and/or system bugs, some EPs failed to tag correct BCANs to the orders. This issue often arises when manual input is required during order placing process, which heavily relies on staff's selection of the correct trading account, correct input of account number and/or BCAN.
- (ii) Due to incorrect system configuration deployed by the system vendor, orders were incorrectly tagged with the reserved BCAN value "1" instead of the actual BCANs of the relevant clients.
- (iii) Some EPs have misunderstood the usage of the reserved BCAN value "1" and "2", resulting in a wrong BCAN tagging.
- (iv) Due to incorrect system logic in trading system, some EPs replaced the BCANs tagged by their RRI clients with BCANs they had incorrectly assigned to those clients.

▪ ***Incorrect Usage of <BCAN error report>***

- (v) Due to misunderstanding of the report usage, some EPs incorrectly submitted <BCAN Error Report> instead of <Trade Discrepancy Form> for reporting errors that were not related to wrong BCAN tagging. EPs should note that <BCAN Error Report> should not be used to reflect any trade reallocation from client accounts to their house accounts resulting from trade errors such as incorrect trade quantity / price / stock.

▪ ***Failure to submit the report with accurate data and in a valid format***

- (vi) Some EPs did not realize their reports were rejected by the Exchange due to input errors. Such situation was left unnoticed because they had not implemented any controls such as reviewing the Response File and/or Result File to ensure reports were error-free and accepted by the Exchange.

7. **BCAN Confidentiality** ([HKIDR Information Paper](#) paragraph 14)

▪ **Access rights to BCAN not granted strictly on a need-to-know basis**

Due to misunderstanding of the relevant requirement, some EPs did not have appropriate arrangements in place to keep clients' BCANs confidential and to ensure they only grant access to BCAN to relevant staff members strictly on a need-to-know basis.

8. **BCAN Assignment** (*SEHK Rule 538A(3)*<sup>1</sup>)

It was noted that a number of EPs have unnecessarily assigned BCANs to their RRI clients due to various reasons as set out below:

▪ **Lack of procedures in identifying or properly classifying a client as RRI**

Some EPs have not adopted appropriate procedures during the client onboarding process to properly identify and verify (1) whether the client is a licensed corporation ("LC") or registered institution ("RI") as defined under Securities and Futures Ordinance, and (2) the client's trading capacity, in order to determine whether such client should be classified as a RRI.

▪ **Misunderstanding of the RRI classification**

Some EPs do not have a clear understanding that not all LCs and RIs are considered as RRI and subject to the HKIDR related obligations. As such, there is a need for proper RRI classification to determine whether BCAN assignment to such client is necessary, and accordingly, adopt necessary controls and/or system changes.

▪ **System bugs in BCAN assignment process**

Some EPs, despite having proper RRI classification, failed to prevent assigning BCANs to their RRI clients due to system issues.

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<sup>1</sup> EPs are required to observe the requirements under paragraphs 5.6 of the SFC Code of Conduct in relation to BCAN assignment. SFC Code of Conduct refers to the "Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission" which could be located on [SFC website](#).

## 9. Policies and Procedures

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

***Investor Identification.*** Some EPs failed to establish adequate written policies and procedures in relation to the waterfall requirements on the collection and submission of CID, BCAN assignment, BCAN client type classification, and submission of BCAN-CID Mapping File and Reporting Forms<sup>2</sup> for the purpose of ensuring compliance with the investor identification requirements under SEHK Rule 538A.

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

## 10. Staff Training

- ***Inadequate staff training, and lack of adequate audit trails for training record***

Some EPs did not provide adequate training for staff involved in handling procedures relating to the investor identification requirements but merely relied on on-the-job training through sharing and coaching by senior staff members. In some instances, EPs failed to provide audit trails to demonstrate that the trainings have been conducted as presented to the Exchange.

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

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<sup>2</sup> “Reporting Forms” refer to the Aggregated Transaction Report, BCAN Change Report, BCAN Change for LP Quote Report, BCAN Error Report and Off-Exchange Trade BCAN (Buy-side) Report. The templates of the five reporting forms are provided on the [HKIDR web corner](#).

### **Good Practices Observed**

EPs are reminded to observe and comply with the BCAN requirements as set out in SEHK Rule 538A, and to refer to various guidance, including but not limited to the [File Interface Specification \(for BCAN-CID Mapping File and Reporting Forms\)](#), [HKIDR Information Paper](#) and [HKIDR File Submission and Order Tagging FAQ](#).

In addition, EPs should put in place necessary controls and arrangements, and regularly assess their effectiveness such that they can, amongst other things, (i) ensure BCAN client type and CID submitted to the Exchange are accurate and up to date, (ii) ensure timely submission of BCAN-CID Mapping File and Reporting Forms, (iii) keep BCANs strictly confidential and (iv) ensure BCAN assignment is correct. Furthermore, EPs 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 also be in place to ensure that the controls and arrangements are implemented as designed and in a consistent manner. When systems are involved (regardless in-house built or by external vendor), proper and thorough testing should be conducted prior to the launch of any new system, system migration, or enhancement to ensure the intended controls and procedures are effectively implemented to comply with the relevant rules and requirements. Post-release testing is also necessary to verify that the system functions correctly in the live environment and promptly address any issues that may arise. Not least, adequate training should be provided to staff involved in BCAN-related process on a regular and on-going basis.

Apart from the above, the Exchange wishes to draw EP's attention to some of the good practices that we observed during the onsite inspection:

#### Client Onboarding

- (i) Some EPs conduct independent review on all client information obtained during onboarding to ensure data accuracy and correct client type classification.
- (ii) Some EPs would confirm with their corporate/institutional clients during onboarding to ensure they are not a RRI and also verify this independently before assigning a BCAN to them. They also conduct regular reviews to ensure such understanding remains valid.

#### Regular Review of BCAN-CID Mapping File

- (iii) Some EPs perform regular review on all data in the BCAN-CID Mapping File, including but not limited to any changes made (e.g. addition/deletion/amendment) and conduct 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.

#### BCAN-CID Mapping File and Reporting Forms Submission

- (iv) After submitting the BCAN-CID Mapping File, some EPs promptly review the BCAN-CID Response File, BCAN-CID Validation Result File and BCAN Full Image File distributed by the Exchange to ensure successful submission and processing before enabling the BCANs for order tagging. Additionally, some EPs have implemented system controls to reject orders tagged with BCANs not included in the BCAN-CID Mapping File submitted on or before T-1 day by checking against the BCAN Full Image File.
- (v) Following the submission of the Reporting Forms, some EPs conduct a thorough review of the Response File and Result File to ensure all submitted records are successfully processed and accepted by the Exchange. In addition, some EPs set an earlier internal deadline for report submission, and have allocated buffer time for exceptional handling. This helps ensure that, in case any record fails validation, they would have sufficient time to review the whole record and correct the information for resubmission within the submission window.

#### Implement Automation and Establish Comprehensive Policies and Procedures

- (vi) Adopt automation and minimize manual intervention as much as possible. Where manual procedures are involved, maker-checker mechanism is implemented with audit trail and proper documentation made in the written policies and procedures.
- (vii) Some EPs have established error trade handling procedures which offer a clear guidance to staff on the proper use of the <BCAN Error Report> and <Trade Discrepancy Form>.
- (viii) Some EPs have established and maintained comprehensive policies and procedures to clearly define the timeline, roles, and responsibilities of the relevant Front Office and Back Office staff for the submission of Reporting Forms. Certain EPs have implemented automated controls to identify reportable transactions, generate reports in the required format, and reconcile the reported items with their internal records to ensure timely, complete and accurate reporting.

EPs are encouraged to make reference to our Compliance Bulletin (Ref. No.: [MSM/005/2024](#) and [MSM/009/2023](#)) which listed out some common deficiencies and related issues identified, and also good practices observed with respect to compliance with the relevant HKIDR requirements.