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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: Closing of 2021 Annual Attestation and Inspection Programme

Enquiry: surveillance@hkex.com.hk

With reference to the circular (Ref. No.: MSM/002/2021) dated 26 February 2021, the Hong Kong Exchanges and Clearing Limited (“**HKEX**”) is pleased to announce that it has successfully completed the 2021 Annual Attestation and Inspection Programme (the “**2021 Programme**”).

Under the 2021 Programme, HKEX inspected 32 Exchange Participants¹ and Clearing Participants² (collectively, the “**Participants**”). HKEX also received 100% response on self-attestation questionnaires from 772 Participants on compliance with the relevant rules and requirements on China Connect Rules, Manual Trade and Risk Management (collectively, the “**Priority Areas**”).

HKEX noted that in general, most Participants had put in place systems and controls for compliance with the relevant rules and requirements in the Priority Areas. However, certain deficiencies and shortcomings which are common across the Participants were identified. Compliance letters have been issued to a total of 48 Participants with recommendations for improvement in a number of areas, including:

- Breaches of certain BCAN requirements and investor eligibility requirements;
- Inadequate controls for fulfilling certain Manual Trade reporting requirements;
- Inadequate control arrangements on settlement operations, funding estimation and position management, as well as exposure monitoring and funding arrangement;
- Inadequate stress testing in terms of frequency and stressed scenarios on proprietary / client exposures;
- Lack of comprehensive framework and failure to implement proper arrangements to manage business continuity and operational risk; and
- Failure to notify clearing houses of the additional operations and risk control measures associated with new business activities.

¹ Exchange Participants of The Stock Exchange of Hong Kong Limited

² (i) Clearing Participants and General Clearing Participants of HKFE Clearing Corporation Limited, and (ii) Direct Clearing Participants and General Clearing Participants of Hong Kong Securities Clearing Company Limited and The SEHK Options Clearing House Limited

With a view to raising the awareness of Participants' compliance in the Priority Areas, we set out our key findings and elaborate on our compliance reminders in the Appendices ("**Compliance Reminders**"). The provisions highlighted in the Compliance Reminders are not exhaustive and may be subject to change from time to time. Participants are expected to keep abreast of all the relevant rules and regulations applicable to them.

Participants should review their current practices and procedures against our Compliance Reminders, adopt appropriate measures to strengthen their controls, and where necessary, take immediate actions to rectify any breaches or deficiencies.

HKEX takes any rule breaches or deficiencies seriously and may consider taking disciplinary actions against any non-compliant Participants, including issuance of warning letter, imposition of fine and instigation of disciplinary proceedings.

HKEX will continue its efforts in enhancing the industry's understanding and compliance with the relevant rules and requirements through compliance reminders, guidance notes and frequently asked questions.

Participants are encouraged to contact the Market Surveillance and Monitoring Department (email: surveillance@hkex.com.hk) should they have any feedback or questions regarding this circular.

Felix Wang
Head
Market Surveillance and Monitoring
Operations Division

This circular has been issued in English with a separate Chinese translation of the same. If there is any discrepancy between the Chinese version and the English version, the English version shall prevail.

Appendix 1

Compliance Reminder on Manual Trade
(Applicable to SEHK Participants only)

Under Chapter 5 of the Rules of the Exchange (“**SEHK Rules**”), Exchange Participants (“**EPs**”) should observe the general principles of the relevant rules and establish controls and processes to ensure that (i) manual trades are reported accurately and timely to the Exchange and (ii) the price of manual trades concluded during the Continuous Trading Session (“**CTS**”) are within the prescribed price range.

In the 2021 Annual Attestation and Inspection Programme, some EPs were found to be deficient in the following areas:-

1. Reporting of Manual Trades

- ***Failure to report the manual trades to the Exchange within the prescribed timeframe due to misunderstanding of the requirements.***
- ***Misunderstanding regarding the term “conclusion of the transactions”***

The time a transaction is concluded is misunderstood as the time when the trade is reported to the Exchange. Generally speaking, it should instead refer to the point of time at which the trade details are confirmed (either through oral or written confirmation) between the buying and selling parties.

- ***Inadequate controls / arrangements to ensure all manual trades are reported accurately and timely to the Exchange***

Some EPs mistakenly believed that no control is required due to the limited trading size and volume.

EPs are reminded to observe and comply with SEHK Rules 520(1) to (3), and 526(1) to (2).

EPs are also reminded that they are required to report the manual trades to the Exchange within the prescribed timeframe. Specifically,

- Within 15 minutes after the conclusion of the transactions in respect of direct and non-direct business transactions; and
- Within 1 minute after the conclusion of the transactions in respect of direct business transactions which are ATS transactions.

In any event, the reporting should be made not later than the timeframe as stipulated in the relevant rules.

2. Post-trade Review of Reported Manual Trades

- ***Lack of post-trade review for the purpose of timely identification of errors and/or non-compliance incidents in relation to manual trade reporting***
 - (i) Some EPs failed to put in place appropriate post-trade review to review both sales and purchase journals at the end of each trading session.
 - (ii) Some EPs only conducted post-trade review to check on accuracy of the transaction details, but failed to cover the trade reporting time to ensure they were reported within the prescribed timeframe.

Under Rule 528(1) of the SEHK Rules, EPs are required to review both sales and purchase journals at the end of each trading session, and to report any discrepancy, erroneous transaction or compliant to the Exchange not later than 15 minutes after commencement of the Morning Session of the next trading day.

3. Policies and Procedures

- ***Inadequate policies and procedures and lack of regular reviews***
 - (i) ***Manual Trade Reporting requirements.*** Some EPs failed to incorporate applicable manual trade reporting requirements in their written policies and procedures for the purpose of ensuring compliance with the relevant rules. For example, we noted that some of them did not:
 - clearly define the time of conclusion;
 - clearly specify the manual trade reporting timeframe; and
 - establish clear procedures on manual trade reporting.
 - (ii) ***Review of Sales and Purchase journal and Error Reporting.*** Some EPs failed to establish written policies and procedures in relation to (i) the review of transaction details and/or (ii) error reporting handling for the purpose of ensuring the compliance with SEHK Rules 523 and 528(1).

Non-comprehensive policies and procedures may pose compliance risk as well as operational risk on the EPs. 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 revision should also be conducted to ensure they are consistent, effective and up-to-date.

4. Staff Training

- ***Inadequate staff training.*** Some EPs did not provide adequate and product-specific training for their staffs involved in the business activities of 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 on-going basis.

Appendix 2

Compliance Reminder on Risk Management *(Applicable to Clearing Participants³ only)*

Risk management is one of the key responsibilities of Clearing Participants (“**CPs**”) of HKSCC, HKCC and SEOCH (collectively, the “**Clearing Houses**”), as set out in the admission materials and relevant rules and procedures of the Clearing Houses.

CPs should set up robust risk management frameworks and controls, so as to ensure performing proper assessment, monitoring and mitigation of key risks (including but not limited to, credit risk, liquidity risk, operational risk, market risk and capital inadequacy) at all times.

In the 2021 Annual Attestation and Inspection Programme, control weaknesses were found in the following risk management areas:-

1. Stress Testing

- ***Absence of proper stress testing for its own or clients’ exposure on HKEX’s products, particularly on non-linear products such as options***

Stress testing of non-linear products (e.g. options) is crucial to CPs since the losses of non-linear products would probably increase exponentially under extreme market conditions. CPs with significant activities in non-linear products are expected to implement and conduct stress testing regularly and at least on a weekly basis, to evaluate the potential loss of its portfolio under extreme but plausible market conditions. Proper stress testing policies and procedures should also be established to clearly set out the stress testing methodology, frequency and the review and escalation mechanism.

As a benchmark, the underlying movement adopted by Clearing Houses under extreme but plausible market conditions is $\pm 20\%$ for index options and $\pm 22\%$ for stock options.

Further information on stress testing can be found in the [Annex](#).

³ (i) Clearing Participants and General Clearing Participants of HKFE Clearing Corporation Limited, and (ii) Direct Clearing Participants and General Clearing Participants of Hong Kong Securities Clearing Company Limited and The SEHK Options Clearing House Limited

2. Credit Exposure Management - Monitoring of Position Limit and Late Payment Management

- ***Lack of sufficient and effective monitoring and control on credit exposures***

Client limits (e.g. position limit, credit limit, trading limit and/or limits granted to DvP clients in stock trading to settle on T+2) are imposed by CPs on their clients for controlling their credit exposure. It was noted that while CPs had set up limits for their clients, they had not implemented any system to monitor their clients' positions against limits assigned to them and/or had allowed their clients to transact based on their available funds instead. Policies and procedures in relation to the treatment of outstanding loan payments were also found to be inadequate where follow-up, escalation and provisioning / write-off of such loans were not clearly set out. In addition, it was noted that client limits, once granted, were not subject to regular review.

Client limits should also include limits set in third party systems, including those in HKEX systems that facilitate the management of client exposures. For example, regarding General Clearing Participants' ("GCPs") implementation of pre-trade monitoring on its non-CP clients, it was noted that client limits (e.g. pre-trade limits) are set up but their reviews are conducted separately from other internal client limits during the GCPs' client risk assessment and risk mitigation process.

CPs are reminded to implement appropriate and adequate monitoring arrangements in this regard, including but not limited to inputting the limits assigned to clients into the system for continuous monitoring and timely adjustments of the limits according to changes in client's credit risk. Failure to implement appropriate and adequate monitoring arrangements may result in regulatory breaches, which could be grounds for disciplinary actions.

3. Notification of Change in Operations and Risk Control Plan

- ***Failure to notify the Clearing Houses when there is a change in operations and risk control, including but not limited to changes arising from engaging in new business activities***

According to the responsibilities set out under CCASS Rule 1703(iii), HKCC Rule 214(n) or SEOCH Rule 403(17) and also with reference to the admission material (Note 2 of Attachment 2 of the [“Explanatory Notes for applications for Participantship and Trading Right”](#)), CPs are required to submit to the Clearing Houses any change in the details supplied to the respective Clearing Houses at the time of admission and thereafter including, among other things, updated risk and control documents when engaging in new business activities such as (i) proprietary trading; (ii) stock lending and borrowing; (iii) China Connect market; and (iv) margin financing.

CPs are advised to notify and provide the following information to the Clearing Houses (by email to clearingcreditrisk@hkex.com.hk) when you engage in new business activities:-

- (i) Background of new business, (including the commencement timeline, business strategic plan and target client sector)
- (ii) Financial projection (including the projected size⁴, revenue and profit for the first year of operation)
- (iii) Capital injection / funding plan
- (iv) Associated risks and corresponding risk measures

4. Control, Monitoring and Staff Training in relation to Fulfillment of Settlement Obligations

- ***Inadequate monitoring and controls over Settlement Operations for ensuring the timely completion of steps essential to fulfill the settlement obligation of the Clearing Houses***

CPs should put in place adequate and comprehensive internal controls and procedures governing the relevant money and stock settlement process; and all relevant staffs should strictly follow the prescribed timeline to facilitate smooth operation, especially for backup or holiday covers. Examples of effective tools for settlement controls include: a checklist with maker-checker signoff over key settlement steps (with timelines clearly set out for each step); or a system dashboard to monitor the timeliness in completing each key settlement steps with automatic escalation / alerts. For each key settlement task, sufficient buffer time should be allocated between the internal completion timeline and the Clearing Houses' settlement timelines, in order to allow exception handling process (e.g. additional transfer of funds) to be completed before the Clearing Houses' settlement timelines.

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 handling exceptionally large positions. This includes process to reduce the position for computation of collateral requirements, such as by providing Specific Cash Collateral or Specific Stock Collateral to HKSCC for its large long or short stock positions under CNS System respectively.

CPs are advised that the review of funding sufficiency at market close should be based on the actual position data or settlement reports disseminated by Clearing Houses. By merely relying on internal position data (instead of Clearing Houses' date/report) during the funding forecast/arrangement process, CPs may not be able to capture errors caused by internal system or manual process e.g. incorrect/incomplete positions net-down in HKCC/SEOCH. This would lead to an incorrect forecast of the settlement amount and may result in payment failure.

⁴ Examples of parameters to consider for each type of new businesses are set out below:

- (a) for proprietary trading, asset value and value-at-risk
- (b) for stock lending and borrowing, value and type of securities on loan
- (c) for China Connect market, transaction volume
- (d) for margin financing, list of acceptable stocks and loan book value

CPs are also advised to regularly review its operational and funding backup arrangements to ensure their effectiveness. The review should include but not limited to (i) holiday backup arrangement of settlement and accounting officers; (ii) enabling money transfer through e-banking between house / client accounts and CPs' designated account for settlement; and (iii) setting up overdraft facilities to provide contingency funding (including non-HKD settlement currency e.g. CNY for China Connect Participants).

CPs should keep abreast of the circulars issued by the Clearing Houses from time to time and conduct regular reviews on their operation procedures to ensure compliance with the relevant rules and requirements at all times. Among other things, CPs should ensure that their settlement arrangements (including arrangements during holiday periods) comply with the latest requirements stipulated by the Clearing Houses.

CPs should ensure that their staffs (including their backup and holiday cover) have adequate and up-to-date knowledge pertaining to operational risk and control, payment obligations and the consequences of failure in meeting the obligations of the Clearing Houses. CPs should also arrange for staff to attend training courses, such as the one mentioned in the circular "[Training course jointly organized by HKEX and HKSI Institute](#)" issued by the Clearing Houses on 31 December 2018 (Ref. No. CD/CDCRM/243/2018) and make reference to circulars such as "[Reminder on Payment Obligations of Clearing Participants](#)" issued by the Clearing Houses on 9 February 2022 (Ref. No. [CD/CDCRM/052/2022](#), [CD/CDCRM/050/2022](#) and [CD/CDCRM/051/2022](#)) to enhance staff's awareness of payment obligations to the Clearing Houses.

5. Risk Governance, Operational Capability and Risk Culture

▪ ***Inadequate control in relation to risk management governance***

A proper risk governance framework usually involves establishment of a risk committee for exercising senior management oversight over key risk areas. In some instances, CPs did not keep proper meeting records/reports to support that committee meetings had been conducted or the focus items had been discussed by senior management at those meeting.

CPs should establish a proper risk governance framework (e.g. by setting up a risk committee with regular meetings) and maintain documentation to demonstrate senior management's oversight of issues and to keep track of their discussion and monitoring over key risk areas, in particular, on the treatment of credit risk, concentration risk and monitoring of sufficiency of liquid capital.

CPs should also establish detailed policies and procedures to ensure key risks involved in their business are effectively managed. In this connection, Attachment 2 of the "[Explanatory Notes for Application for Participantship and Trading Right](#)" can serve as a reference of the Clearing House's latest expectation on a CP's risk management practices.

6. Third party service management

- ***Inadequate control in relation to system changes***

CPs should establish proper review and testing procedures in relation to any system changes. In some instances, CPs failed to spot the logic error during critical system enhancement (e.g. system changes on margin offset claim logic) made by third party system providers.

CPs are advised to strengthen its control on critical system changes, for example, system changes that has impact on settlement and margin calculation. Such controls should include (i) thorough user acceptance testing and (ii) parallel run to ensure a smooth transition.

7. Business Continuity Plan and Contingency Funding Arrangement

- ***Inadequate arrangement in place to ensure its fulfillment of the Clearing Houses' settlement obligations under contingent situation***

To cope with disruptions that may impair CPs' ability to meet settlement obligations to the Clearing Houses, CPs should develop and maintain a business continuity plan, which should clearly set out the actions that they would take during contingent scenarios. In view of the latest COVID pandemic situation, CPs should review their business continuity plan and consider whether they have granted sufficient authorization to the relevant colleagues during split team arrangement and whether the plan covered the contingency handling of the forthcoming trades (e.g. routing to a peer broker or putting timely stop to client orders) in case the operation capability was impaired (e.g. due to quarantine of a large number of operational staff). CPs should also enhance its capability to enable staff's remote access to trading/clearing system.

8. Risk Management Framework Establishment and Implementation

- ***Risk Management Framework***

Risk Management Frameworks outline the organizational and resource requirements for designing, implementing, evaluating, improving and integrating risk management throughout the organization and support the associated decision-making processes. In some instances, CPs failed to demonstrate that such framework has been established. CPs are advised to implement and/or strengthen their risk management framework design and implementation, through (i) establishing a clear risk governance structure with defined roles and responsibilities; (ii) defining their risk appetite; (iii) developing risk management policy; and (iv) embedding the Risk Management Cycle and assessment procedures.

- ***Risk Appetite Framework***

The Risk Appetite Framework refers to the aggregate level and types of risks that an organization is willing to accept or avoid in order to achieve its strategic objectives and business plan. It was observed that while CPs have set up a high level Risk Appetite Statement, the risk appetite coverage was often limited to financial risks and not subject to regular assessment. CPs are advised to establish and implement the risk appetite framework with defined tolerance thresholds for all major risk types. CPs are recommended to conduct regular assessments of the tolerance thresholds to ensure they remain relevant in the decision-making processes.

- ***Risk Management Cycle***

The Risk Management Cycle can be summarized into four major steps (i) Identification, (ii) Assessment, (iii) Mitigation, and (iv) Monitoring & Reporting. The Risk Management Cycle enables timely provision of information on risk matters to management to support an effective and informed decision-making and facilitate formulation of necessary remediation actions. In some instances, CPs did not document the process on risk escalation and reporting. CPs are recommended to embed a suitable Risk Management Cycle into their organizations.

9. Operational Risk Controls Implementation

- ***Implement Controls for Core Operations & Key Controls Assurance***

Well established policies, procedures and controls help to maintain operational effectiveness of the organization. CPs are advised to implement control procedures in particular on those related to manual operations and where end-user self-deployed applications are involved. CPs should also identify their organization's critical processes, key risks and controls, and accordingly, implement a control testing framework to regularly review and assure the operating and design effectiveness of those key controls.

- ***System Access Controls***

System access controls are fundamental to prevent unauthorized access to systems and ultimately, to safeguard data privacy. It is noted that while CPs have established and implemented relevant internal policies, procedures and controls to govern system access, they were not subjected to regular review. CPs are recommended to enhance their controls on system access via documenting the performance and results of periodic access recertification.

- ***System Capacity Review***

Adequate technology system capacity enables CPs' core operations and clearing activities with the Clearing Houses. In some instances, CPs only implemented real time system capacity monitoring and alerts. To enhance this control, CPs are advised to implement a regular system capacity review process to ensure that current and future system usage requirements are met and well anticipated respectively.

- ***Oversight on third parties***

It was observed that some CPs engage third parties to service or support products that are critical to their operations. CPs are advised to establish oversight and implement preventative measures on their third parties to ensure seamless operation.

10. Business Continuity Management

- ***Availability of Incident Management Plan***

The objective of having an Incident Management Plan is to identify, assess, rectify and learn from disruptive incidents as well as to mitigate the severity and prevent any recurrence. In some instances, CPs failed to demonstrate whether an incident management process had been established, or if the established process was reviewed regularly. CPs are advised to establish and document an Incident Management Plan to ensure that incident classification, escalation, reporting, communications and post incident reviews are performed in an effective manner across the organization, and are able to meet the expectation from key stakeholders and regulators; in which the process should be reviewed at least annually. CPs should document, report and escalate significant operational disruption events to HKEX as part of a well defined protocol.

- ***Availability of Business Continuity Plan***

Business Continuity Plan (“BCP”) helps ensuring an organization is able to respond to and recover from disruptive incidents. In some instances, CPs failed to demonstrate existence of their BCP, or the BCP documents are not reviewed at least annually. Further, some CPs did not conduct trainings or drills to ensure the effectiveness of their BCP. CPs are advised to develop and document BCP to address various disruptive scenarios identified, and set out corresponding procedures for activating the plans. CPs should also review the plans, arrange training for staff and conduct drills at least annually.

- ***Participation in HKEX Data Centre Site Failover Drill***

HKEX organizes Data Centre Site Failover Drill annually to enable CPs and related parties to familiarize themselves with contingency procedures and related operational matters in the event of service outage in the HKEX primary data centre. It was noted that some CPs did not participate in the annual drill. CPs are advised to participate in the HKEX Data Centre Site Failover Drill annually to ensure the connectivity with HKEX Disaster Recovery environments and the corresponding contingency procedures are validated.

In addition, the SFC has released “[Report on Operational Resilience and Remote Working Arrangements](#)” (“Report”) in October 2021 which laid down the operational resilience standards and required implementation measures, supplementing the SFC’s existing guidance. CPs are encouraged to refer to the mentioned Report for best practice techniques, procedures and case studies for embedding in their framework, procedures and operations.

Appendix 3

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 2021 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 / system migration, human intervention in the BCAN assignment process, vendor system limitation and deficiencies in system design were common reasons that led to multiple BCANs being generated and assigned to the same client. In some other cases, the same client was being treated as different persons when different types of identity documents were used for account opening.
- (ii) Misinterpretation of rules resulted in assignment of different BCANs to
 - an entity with different branches;
 - an intermediary’s proprietary and agency accounts for which only the intermediary’s Client Identification Data (“**CID**”) was provided;
 - a segregated portfolio company which is a single legal entity; and
 - clients with multiple accounts such as cash and margin accounts, master and sub-accounts, fund and fund manager accounts, segregated accounts set up for different strategies or purposes (e.g. a standalone account for Capital Investment Entrant Scheme related trading) etc.

- ***Inaccurate CID and BCAN client type provided in the BCAN-CID Mapping File***
 - (i) Due to misunderstanding of the classification requirement, some CCEPs mistakenly assigned the house accounts of their corporate and institutional clients 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) Some CCEPs failed to assign the corresponding client type for its 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)
 - (iii) Due to misunderstanding of the BCAN-CID mapping data submission requirements, some CCEPs failed to provide the exact CID as shown on clients' official identity documents.
 - (iv) Some CCEPs inadvertently provided the fund manager's CID for clients that use the fund as the legal entity for opening the trading account with CCEPs.

- ***Insufficient controls / arrangements to ensure BCANs are kept confidential***
 - (i) ***BCAN bears obvious link to client's identity.*** Some CCEPs assigned client with a BCAN, part of which is formed by the client's account number. Accordingly, the CCEPs failed to prepare the BCAN in a way that do not bear any obvious link to a client's identity as required.
 - (ii) ***BCAN access not granted on a need-to-know basis.*** Some CCEPs displayed the BCANs in their internal systems and failed to ensure that the use of and accessibility to BCANs are strictly restricted on a need-to-know basis.

- ***Insufficient controls to ensure correct BCAN tagging***
 - (i) Human errors in processing high-touch orders have led to incorrect BCAN tagging. Some CCEPs selected the wrong client account when placing the client's order which resulted in wrong BCAN tagging.

- ***Change of BCAN***

- (i) BCANs assigned to clients beyond the non-affiliated intermediary level should not be changed back to intermediary level once assigned, notwithstanding that the original assignment was made on a voluntary basis beyond the minimum rule requirement.
- (ii) BCAN changed from fund to fund manager level (or vice versa), subsequent to account opening may also amount to unauthorized change of BCAN.

- ***Incorrect BCAN assignment for TTEP / client-facing affiliates***

- (i) **TTEP** - A single BCAN was assigned to a TTEP instead of a BCAN range for the TTEP's agency trading. However, 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 its TTEPs. The BCANs of a TTEP for proprietary trading should also be within the same BCAN range designated by its executing CCEP.
- (ii) **Affiliate clients** - BCAN was only assigned to the affiliate (for agency trading), contrary to the Rules and the FAQ which stated that the BCAN should be assigned at the next level or further levels down until the client is not an affiliate.

- ***BCAN assignment for CCEP/TTEP's affiliate with dual capacity***

- (i) For affiliates with dual capacity, only a single BCAN designated with client type "4" was assigned by a CCEP/TTEP to its affiliates for the affiliates to carry out both brokerage business and asset management business. However, a BCAN range should be assigned for its proprietary trading and each of its clients for which it conducts agency trading.

- ***BCAN consent***

- (i) Some CCEPs created BCAN without first obtaining clients' consent and some failed to follow up with the client who refused to provide the BCAN consent.

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 (i) assign unique BCAN to each of their Northbound trading clients, (ii) ensure the 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 is obtained from clients before proceeding with order placing. Additionally, CCEPs and TTEPs are reminded that once 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. In addition, adequate training should be provided to staffs involved in BCAN-related process on a regular and on-going basis.

The Exchange wishes to draw Exchange Participants' ("EP") attention to some of the good practices that we observed during the onsite inspection:-

- (i) 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 EPs would request the client to declare in its account opening form that he/she has not opened any account with the firm previously. Some EPs would also compare other client information (e.g. address, contact number) to identify any potential matches.
- (ii) To handle multiple trading accounts setup arrangement (e.g. cash and margin accounts, master/sub-accounts, fund and fund manager accounts etc.), some EPs assign BCANs based on the ID number for individual clients and business registration number for corporate clients, rather than on trading account level.
- (iii) Some EPs conduct independent review on all client information obtained during onboarding to ensure data accuracy.
- (iv) Some EPs perform regular and timely reconciliation between internal system records and the BCAN-CID mapping file to ensure the CID submitted to the Exchange are complete, accurate and up-to-date.
- (v) 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.

EPs are encouraged to make reference to the recently published Compliance Bulletin ([Ref. No. : 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 CCEP executing via other CCEPs

▪ **TTEP registration**

- (i) On the one hand, some EPs failed to submit a declaration to the Exchange before conducting trading in China Connect Securities for the account of their clients.
- (ii) On the other hand, some CCEPs failed to ensure that their EP clients that wishes to conduct trading through the China Connect Service for the account of its clients have been registered as a TTEP.

▪ **CCEP executing via other CCEPs**

- (i) Some CCEPs conducted China Connect trading activities through other CCEPs for principal and/or agency trading for purposes other than contingency situation.
- (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:-

- (i) Pursuant to SEHK Rule 590(2) and 590(4) and as stated in paragraph 1.43 of the [Stock Connect Frequently Asked Questions](#), 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.
- (ii) TTEPs are required to provide a declaration to the Exchange confirming such matters as the Exchange may require, including the EPs' awareness of and the ability and undertaking to comply with 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 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.
- (iii) 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. Odd Lot Transactions

- ***Trading algorithms in use not in compliance with the odd lot trading requirements***

Some CCEPs use trading algorithms that would slice a client's board lot sell orders into multiple odd lot child orders, in breach of the requirement that all odd lots must be sold in one single order.

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).

EPs are also reminded to observe the order size of SSE and SZSE Securities, which are subject to the board lot size of 100 shares (except for STAR shares whose board lot size is 1 share with minimum order size of 200 shares) as stipulated in paragraph 3.39.1 of the [Information Book for Market Participants in Stock Connect](#).

4. Trading of ChiNext and STAR Shares

- ***Inadequate controls to ensure only Institutional Professional Investors ("IPs") are allowed to trade ChiNext and STAR shares***
 - (i) Some CCEPs failed to have proper pre-trade controls in place to require the intermediaries to ensure that their underlying clients are IPs prior to accepting their orders for trading ChiNext and STAR shares.
- ***Inadequate procedures and controls for a timely identification of non-compliance incident in relation to Investor Eligibility requirement***
 - (i) Some CCEPs relied entirely on the pre-trade system controls to block non-IPs from trading ChiNext and STAR shares, which is considered insufficient for the purpose of timely identification of non-compliance incidents.
 - (ii) Some CCEPs only conducted post-trade review at direct client level, but failed to cover all clients including the underlying clients of the intermediaries.

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 requirements for trading in ChiNext and STAR shares respectively under SEHK Rules 14A06(13) to (15) and 14B06(16) to (18).

EPs are encouraged to make reference to the recently published Compliance Bulletin ([Ref. No.: 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.

5. Policies and Procedures

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

- (iii) ***BCAN requirements.*** Some CCEPs only relied on the operational manual provided by the system vendor, but failed to establish their own 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.
- (iv) ***TTEP registration.*** The written policies and procedures of some CCEPs contained inadequate 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.
- (v) ***ChiNext and STAR trading.*** The written policies and procedures of some CCEPs contained inadequate details and guidance relating to the (i) regular review on the IPI status of their clients, and/or (ii) regular and appropriate post-trade review to cover all clients including the underlying clients of intermediary broker clients, 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).

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.

6. 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 staffs with adequate and appropriate training both initially and on an on-going basis.