



2021 ANNUAL ATTESTATION & INSPECTION PROGRAMME

MARKETS
MARKET SURVEILLANCE & MONITORING

HKEX
香港交易所

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Agenda

01 | Overview of HKEX Rule Enforcement Framework

02 | 2021 Priority Areas

i | China Connect Northbound Trading

ii | Manual Trade

iii | Risk Management



Overview of HKEX Rule Enforcement Framework



HKEX Rule Enforcement – Key Principles

Prevention

- Enhance industry understanding of HKEX Rules through:
 - ✓ Briefing sessions
 - ✓ FAQs, guidance notes, circulars and reminders
 - ✓ Compliance Roundtable
 - ✓ Chatbot¹

Detection

- Identify non-compliance through daily monitoring and self-reporting by Exchange Participants / Clearing Participants
- Introduced **Annual Attestation and Inspection Programme** (since 2017):
 - ✓ Self-attestation of compliance with HKEX Rules
 - ✓ Onsite inspection

Correction

- Pursue corrective actions, depending on seriousness of breaches and violations:
 - ✓ Rectification measures
 - ✓ Disciplinary actions



¹ Our Chatbot, Aiden, can be located on [HKEX website](https://www.hkex.com.hk).

2021 Annual Attestation and Inspection Programme

Priority Areas

| | 2017 | 2018 | 2019 | 2020 | 2021 |
|---------------------------------|---------------------------|--|------------------------------|---|-----------------|
| Coverage | Cash Market | Cash and Derivatives Market | | | |
| | 375 EPs | ~800 EPs and CPs | | | |
| | SEHK Exchange Rules | SEHK, HKFE, HKSCC, SEOCH, HKCC Exchange and Clearing Rules | | | |
| Cash Market | Manual Trade | | | | Manual Trade |
| | Short Sell Order Flagging | China Connect | China Connect | China Connect | China Connect |
| | China Connect | | | | |
| Derivatives Market | | Client Margin Requirements / Established Client | Position Limit LOP Reporting | Client Margin Requirements / Established Client | |
| Clearing Houses | | Risk Management | Risk Management | Risk Management | Risk Management |
| Compliance Advice Issued | 12% [46] | 11% [81] | 12% [95] | 6% [47] | - |

Annual Attestation and Inspection Programme

Self-Attestation of Compliance

- Apply to **all Exchange Participants¹ and Clearing Participants²**
- Perform self assessment on compliance with relevant HKEX Rules
- Complete **Self-Attestation Questionnaire** prescribed by HKEX
- Submit the Questionnaire, along with any supporting documentation, via the **Electronic Communication Platform (ECP)**

Onsite Inspection

- Apply to **selected Exchange / Clearing Participants** based on risk assessment
- A more detailed evaluation of Exchange / Clearing Participants' compliance with the relevant HKEX Rules
- Inspectors will conduct **Onsite Inspection** at the participants' premises

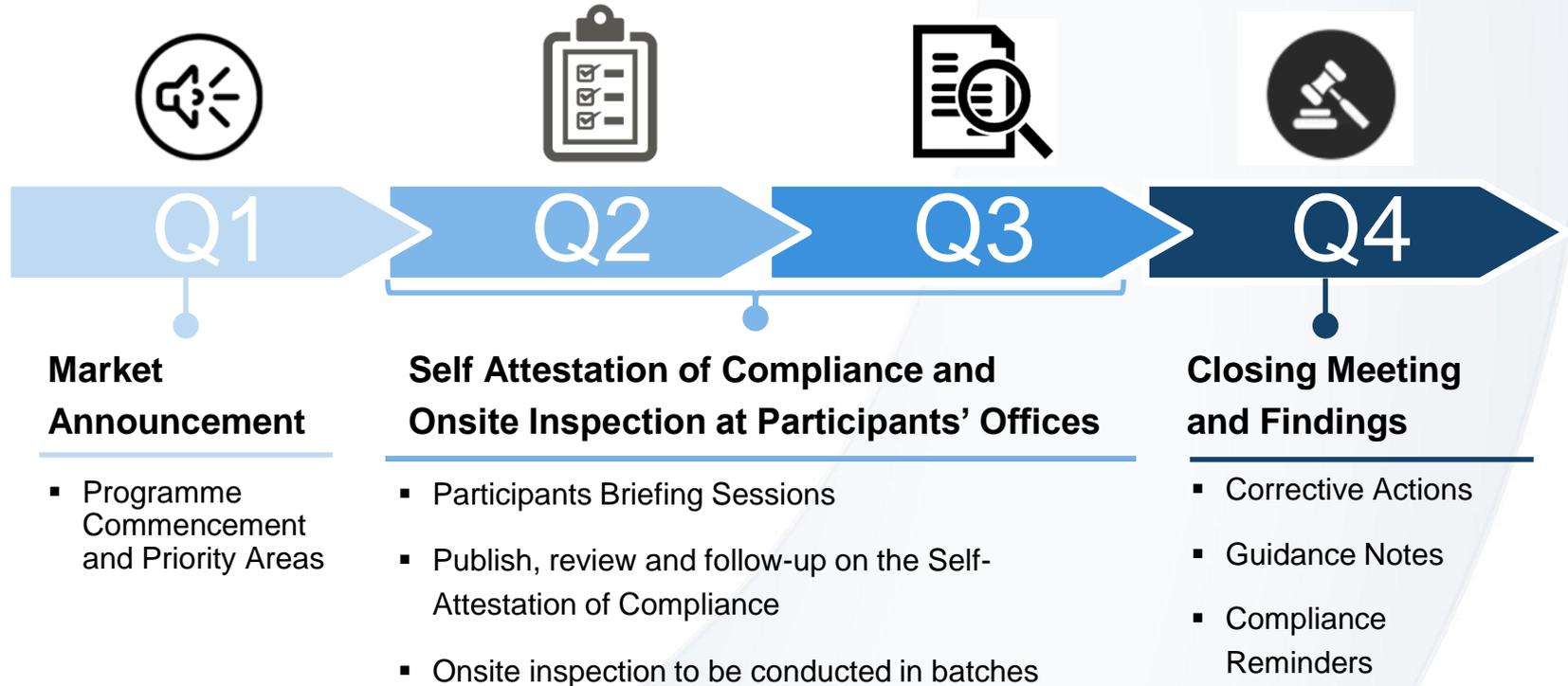
¹Exchange Participants of The Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited (the "EPs")

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



Annual Attestation and Inspection Programme

Timeline



Onsite Inspection

Pre-Inspection Information Request

(4 weeks to prepare and submit)

- Documents and records that can demonstrate compliance of the relevant rules should be submitted to HKEX Inspectors.
- These documents can be:
 - ✓ Policy, guidelines, manuals and procedures
 - ✓ Workflow / system flow
 - ✓ Internal training materials and records
 - ✓ Other relevant documents

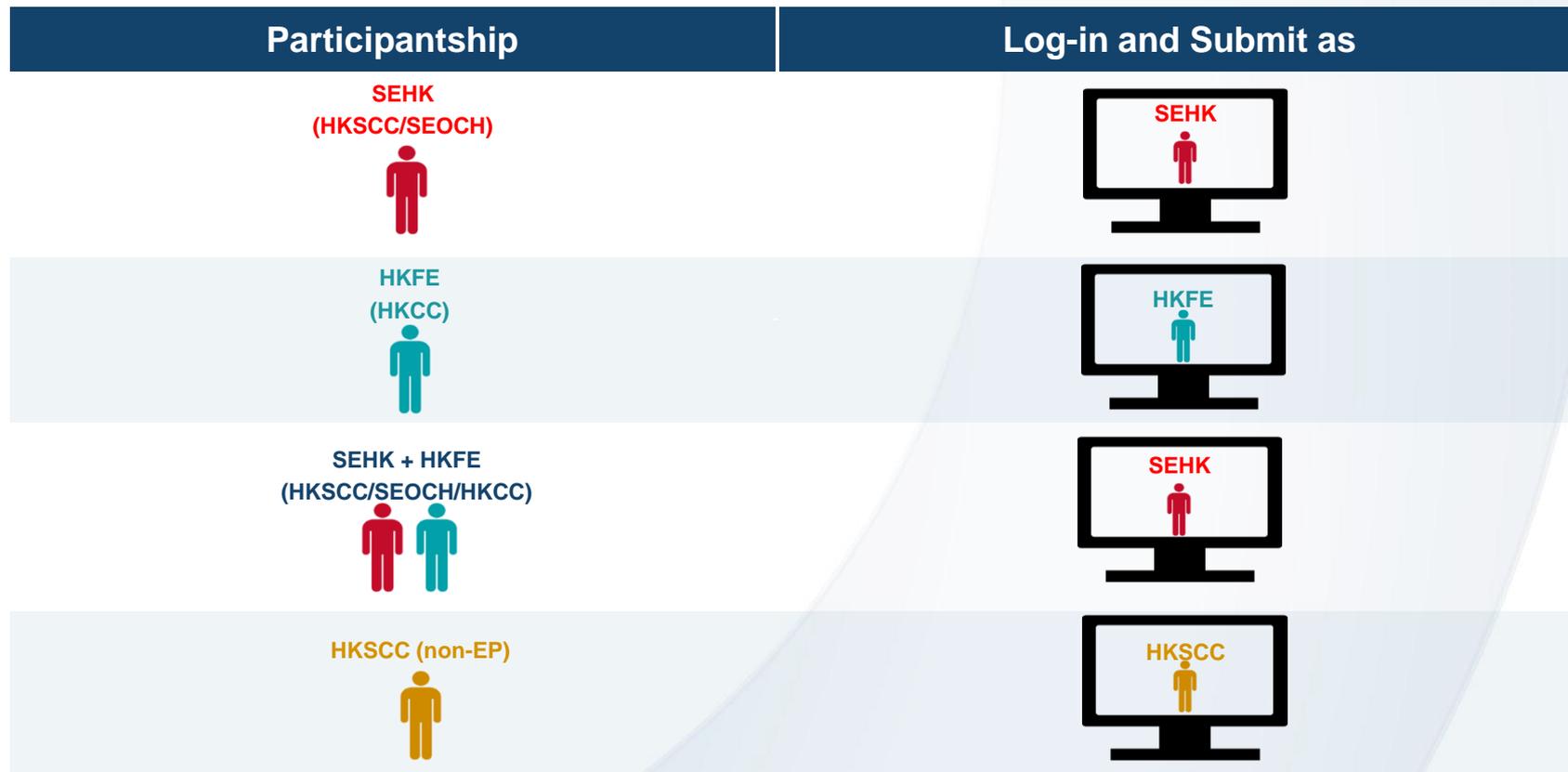
During Onsite Inspection

(<2 days)

- In general, these staffs should participate in the onsite inspection meeting with HKEX Inspectors:
 - ✓ Responsible Officers
 - ✓ Senior management with oversight of the relevant Priority Areas
(e.g. business heads, Head of Operations, Head of Compliance, Head of Risk Management etc.)
 - ✓ Experienced staff of the responsible areas
- Staff attending the meeting will be expected to describe their policy and procedures, walk through workflow / system flow, explain internal controls and processes, and answer any queries from the HKEX Inspectors.



Submission of Self-Attestation of Compliance via ECP



Link to ECP: <https://www.ecp.hkex.com.hk/>

ECP Administrator Contact: (Email) ecpadmin@hkex.com.hk or (Tel) 2840 3933

Reminders on Attestation Submission

The 2021 Self-Attestation of Compliance Questionnaire

- will be announced via Participant Circulars
- will be published on [HKEX Rule Enforcement website](#)
- will be embedded with data validation function

Action Now

- ✓ subscribe to [HKEX News Alert](#)
- ✓ make sure your ECP account is in active status



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| <input type="checkbox"/> | 4. Updates to the Rules of the Clearing Houses |
| <input type="checkbox"/> | 5. Research Materials |
| <input checked="" type="checkbox"/> | 6. Participant Circulars - The Stock Exchange of Hong Kong Limited (SEHK) |
| <input checked="" type="checkbox"/> | 7. Participant Circulars - Hong Kong Securities Clearing Company Limited (HKSCC) |
| <input checked="" type="checkbox"/> | 8. Participant Circulars - Hong Kong Futures Exchange Limited (HKFE) |
| <input checked="" type="checkbox"/> | 9. Participant Circulars - HKFE Clearing Corporation Limited (HKCC) |
| <input checked="" type="checkbox"/> | 10. Participant Circulars - The SEHK Options Clearing House Limited (SEOCH) |
| <input type="checkbox"/> | 11. Member Circulars - OTC Clearing Hong Kong Limited (OTC Clear) |



Reminders on Attestation Submission

Participants should:

- complete and submit on or before the submission deadline
- complete and submit in editable form (do not modify the questionnaire or submit a scanned copy of the questionnaire) - *Adobe Acrobat is recommended*
- submit together with any supplementary information as **one file** in ".zip" format (no other zip file and no mutli-level folders within the zip file) – *WinZip is recommended*
- limit your zip file to 4MB max
- note the zip file naming convention:
 - (a) Group 1 (SEHK, HKSCC and SEOCH participants) - MSM01_XXXXX_YYYYMMDD.zip; or
 - (b) Group 2 (HKFE and HKCC participants) - MSM04_XXXXX_YYYYMMDD.zip.
- make sure the submitted questionnaire is **complete, true and accurate**



2021 Priority Areas



General Observations

Policies and Procedures

Common Deficiencies

- Summarizes applicable rules and regulations, but lacked details on controls to ensure compliance.
- Inadequate on the policies and procedures coverage; some procedures set out details on part but not all of the controls / systems / order placing channels
- No regular review and revision

Compliance Reminder

- Comprehensive 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.

Training

Common Deficiencies

- No adequate and product-specific training for responsible staff involved in the priority areas on regular basis i.e. both initially and on an ongoing basis
- Some merely relied on on-the-job training through sharing and coaching by senior staff members

Compliance Reminder

- To foster a culture of compliance, EPs should provide adequate and appropriate training to all its responsible staff, both initially and on an ongoing basis.



2021 Priority Areas

China Connect Northbound Trading



China Connect Northbound Trading

List of Enforcement Focus

1. **Broker-to-Client Assigned Number** (SEHK Rule 1425A)
2. **Investor eligibility requirement for trading of ChiNext shares and STAR shares**
(SEHK Rules 14B06(16)-(18), 14A06(13)-(15))
3. **Odd lots** (SEHK Rule 14A06(3), 14B06(4))
4. **Trade Through Exchange Participant** (SEHK Rule 590)
5. **Client agreement and risk disclosure** (SEHK Rule 14A10, Rule 14B10)
6. **Margin trading confined to Eligible SSE / SZSE Securities for Margin Trading**
(SEHK Rule 14A15, Rule 14B15)
7. **Pre-trade checking and post-trade monitoring**
(SEHK Rules 14A06(4), 14B06(5), 14A06(9)-(10), 14B06(11)-(12), 14A17, 14B17, 1421(2), 1428(1), 1432 and 1433)
8. **Foreign investors shareholding limit** (SEHK Rule 14A08, Rule 14B08)
9. **5% shareholding disclosure requirement** (SEHK Rule 14A09, Rule 14B09)
10. **Quota hogging** (SEHK Rule 1428(1))
11. **Turnaround trading** (not allowed under SEHK Rule 14A06(4), Rule 14B06(5))
12. **Off-Exchange trades or transfers prohibited** (SEHK Rule 14A12, 14B12)
13. **Stock borrowing and lending** (SEHK Rule 14A16, Rule 14B16)
14. **Naked short selling** (not allowed under SEHK Rule 14A17, Rule 14B17)

China Connect Northbound Trading

BCAN – BCAN Assignment

Key Information

- One BCAN for one client
(Rule 1425A(1)(a), FAQ's 3 and 4)
- A separate BCAN for a client's joint account
(Rule 1425A(1)(b) and FAQ 18)
- Assign BCAN to affiliate's clients
(Rule 1425A(1)(d) and FAQ 6)
- Assigned BCAN cannot be changed or re-used
(Rule 1425A(1)(e) and FAQ 4)
- Assign BCAN to fund manager / fund per account opening arrangement
(FAQ 11)

Compliance Reminder

❌ Common Deficiencies

- Multiple BCANs assigned to same client due to system deficiencies or clerical mistakes in manual process
- BCAN not assigned to affiliate's clients
- Changed BCAN without Exchange's prior approval
- Failed to assign BCAN to fund manager / fund per the account opening arrangement

✅ Good practices observed

- Obtain sufficient client information for BCAN assignment and BCAN-CID Mapping File compilation
- Adopt automation to minimize manual input and conduct testing before launch, system migration or enhancement
- Implement maker-checker mechanism to detect human errors
- Provide adequate and regular training to responsible staff



¹ The FAQ on Northbound Investor ID Model ("FAQ") could be located on [HKEX website](#).

China Connect Northbound Trading

BCAN – Accuracy of BCAN-CID Mapping File

Key Information

- BCAN-CID Mapping File should be accurate and up to date.
(Rule 1425A(3) and FAQ 7)
- BCAN client type “3” for a fund.
(FAQ 11 and BCAN-CID Mapping File Example¹)
- BCAN client type “4” for a fund manager or other legal entity.
(FAQ 11 and BCAN-CID Mapping File Example)
- BCAN client type “5” for proprietary or principal trading of the CCEP/TTEP and/or its affiliate(s).
(FAQ 19 and BCAN-CID Mapping File Example)

Compliance Reminder

❌ Common Deficiencies

- Used incorrect BCAN client type (e.g., type 3 for fund manager, type 4 for fund and type 5 for non-affiliated client)
- Accidentally inputted fund manager’s CID when the BCAN was assigned to a fund that it manages
- Failed to correctly reflect changes to clients’ CIDs
- Used incorrect data format to generate the mapping file

✅ Good practices observed

- Obtain accurate and sufficient client information for BCAN assignment and compiling BCAN-CID Mapping File
- Perform regular checks to ensure BCAN-CID Mapping File remains up-to-date and accurate
- Provide adequate and regular training to responsible staff
- Send BCAN client type change request to OTPC@hkex.com.hk



¹ Detailed examples are set out in “[BCAN-CID Mapping File Data Record Examples](#)”

China Connect Northbound Trading

BCAN – BCAN Tagging

Key Information

- Tag correct BCAN each northbound China Connect order on a real-time basis.
(Rule 1425A(4) and FAQ 3)
- Promptly cancel any order tagged with an incorrect BCAN. If such order has been matched, then submit BCAN Error Report to the Exchange.
(Rule 1425A(7))
- Consistently tag BCAN when submitting northbound trading orders for the fund manager or the fund.
(FAQ 11 and Circular (Ref. no. CT/101/18)¹)

Compliance Reminder

❌ Common Deficiencies

- Manually placed an order in the wrong account, resulting in the wrong tagging
- Accidentally changed client's identity when the order was being processed by different systems within the organization
- Failed to follow the specified format when completing the BCAN Error Report

✅ Good practices observed

- Conduct proper testing procedures before launch, system migration or enhancement
- Perform regular checks to identify and rectify any incorrect BCAN tagged as soon as possible
- Use the enhanced BCAN Error Report template² with format checks and make sure the trade details are correct
- Provide adequate and regular training to responsible staff



¹ Circular (Ref. no. CT/101/18) is available on [HKEX website](#).

² The enhanced BCAN Error Report template with format check is available on [HKEX website](#).

China Connect Northbound Trading

BCAN – BCAN Confidentiality

Key Information

- BCAN should be prepared in such a way not to bear any obvious link to a client's identity and must be kept strictly confidential.
- In particular, the use and accessibility of BCANs (even within the CCEP or the TTEP) should be strictly restricted to a need-to-know basis.

(FAQs 4 and 21)

Compliance Reminder

❌ Common Deficiencies

- Used clients' trading account numbers (in full or part) to form the BCANs
- BCANs were displayed in the general enquiry / trading screens of internal systems

✅ Good practices observed

- CCEPs and TTEPs should consider to implement controls and provide proper training to the relevant staff to ensure that BCANs are kept confidential.



China Connect Northbound Trading

Investor Eligibility Requirement for Trading of ChiNext Shares and STAR Shares

Key Information

- **Institutional Professional Investors* (IPI) Only**
- Where the direct client is an intermediary broker, CCEPs shall require such client to ensure that the underlying customers are IPIs only (*Rule 14B06(18) and 14A06(15)*)
- Where the direct client is an asset manager regulated in Hong Kong or overseas, only the direct client (but not its underlying funds, accounts or customers) must be an IPI

Compliance Reminder

✘ Common Deficiencies

- Failed to put in place prior arrangements with intermediary broker client to ensure that the ultimate client is IPI
- Failed to conduct adequate testing after subsequent modifications made to the system
- Manual override of system control was allowed without proper justification and relevant documentary evidence
- Sent orders to the market for system testing purpose



Note: * Institutional Professional Investor as defined under paragraph 15.2 of the Code of Conduct for Persons Licensed by or Registered with the SFC, means a person falling under paragraphs (a) to (i) of the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance.

China Connect Northbound Trading

Investor Eligibility Requirement for Trading of ChiNext Shares and STAR Shares

✓ Good practices observed

| Client Onboarding | Pre-trade | Post-trade |
|--|---|---|
| <ul style="list-style-type: none">✓ Diligent Know-Your-Client procedures✓ Client agreement contains sufficient provisions✓ Raise compliance awareness of the investor eligibility requirement✓ Establish prior arrangements with the intermediary broker client | <ul style="list-style-type: none">✓ Adopt system controls where possible✓ Conduct thorough User Acceptance test before deployment✓ Conduct routine checks on the data used for the pre-trade control✓ Where manual override is allowed (i.e. soft block), follow maker-check process and maintain evidence and records for the special approvals | <ul style="list-style-type: none">✓ Conduct regular and appropriate post-trade review which covers all clients including the underlying customers of Intermediary Broker Clients✓ Establish a designated function for the monitoring of trading activities and reporting of incident |

China Connect Northbound Trading

Odd lots

Key Information

- Buy orders – **must in in board lots**, where board lot size is **100 shares** (except for STAR shares whose board lot size is 1 share with minimum order size of 200 shares)
- Sell orders – odd lot trading is allowed if it is the **sale of all, and not part**, of the odd lots held in respect of a China Connect Security i.e. all odd lots should be sold in one single order
(SEHK Rule 14A06(3), 14B06(4))

Compliance Reminder

- Reasonable and necessary system and controls to prevent the placing of odd lot buy orders and non-eligible odd lot sell orders.

Trade Through Exchange Participants

Key Information

- 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 other CCEPs for the account of their clients, **after** submitting a declaration to the Exchange, as TTEPs.
(Rule 590)

Compliance Reminder

- EPs must not provide instructions to a CCEP, whether directly or indirectly, to trade in China Connect Securities for the account of their clients before registering as TTEPs.
- 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.



Q & A Session



2021 Priority Areas

Manual Trade



Manual Trade

List of Enforcement Focus

1. Manual Trade Reporting

- Direct Business Transaction (*SEHK Rules 501F(1)-(2), 526(1)-(2)*)
- Non-Direct Business Transaction (*SEHK Rules 501E(2), 520(1)-(2)*)

2. Review of Sales and Purchase Journal, and Error Reporting (*SEHK Rule 501E(3), 523, 528(1)*)

3. Manual Trade Price Rule (*SEHK Rules 501F(3), 518A, 526(3)*)



Manual Trade

Manual Trade Reporting

General Principle: Report off-exchange trades **as soon as you can**

| Transaction Type | Transaction Time | Person Responsible to Report | Reporting Deadline | If transaction not recorded before the close of trading |
|---|-----------------------|---|---|---|
| Non-Direct Business Transaction (SEHK Rules 501E(2), 520(1)-(2)) | Within trading hours | Selling EP* | Within 15 minutes after the conclusion of the transaction *Please refer to SEHK Rule 520(1) for details of reporting deadlines. | Any transaction not recorded in the System before the closing of trading – Report no later than 15 minutes after the commencement of trading of the next Continuous Trading Session. (by 9:45am on T+1) |
| Direct Business Transaction (SEHK Rules 501F(1), 526(1)) | Within trading hours | The EP conducting direct business transactions | ATS (ALP) transactions: • Within 1 minute after the conclusion of the transaction Other direct business transactions: • Within 15 minutes after the conclusion of the transaction *Please refer to SEHK Rule 526(1)(a) for details of reporting deadline. | |
| Direct and Non-Direct Business Transaction (SEHK Rules 501F(2), 520(2), 526(2)) | Outside trading hours | Non-Direct: Selling EP* Direct: The EP conducting direct business transactions | No later than 15 minutes after the commencement of trading of the next Continuous Trading Session. | |

*: For any transaction with non-EP as a buyer or seller, the EP involved in that transaction is responsible to input the transaction details into the System.



Manual Trade

Manual Trade Reporting

Key Information

- **ALL transactions** should be reported to the Exchange.
- **Every transaction** should be reported **within the time limit** after the conclusion of transaction, and **not later than the prescribed timeframe**. (SEHK Rules 501E(2), 501F(1)-(2), 520(1)-(2), 526(1)-(2))
- In respect of **direct business transactions** which are ATS transactions, on a **trade-by-trade basis** immediately and in any case, within 1 minute after the conclusion of the transactions. (SEHK Rules 501F(1), 526(1))

Compliance Reminder

✘ Common Deficiencies

- Under-reporting and Over-reporting of manual trade
- Failed to timely report the transaction within the time limit after the conclusion of transaction
- Default setting in the system to report the manual trades concluded during Closing Auction Session on the next trading day (Before 9:45am)

✔ Good practices observed

- Provide training to the staff involved in manual trade reporting on reporting timeframe
- Review the setting in the reporting system to ensure the proper usage of reporting options
- Sufficient post-trade monitoring should be in place to prevent any delay of reporting



Manual Trade

(1) Review of Sales and Purchases Journals and (2) Error Reporting

Key Information

- **Each buying Exchange Participant** shall review details of the transactions as recorded in its favour in the System and reject any erroneous input **as soon as it discovers an error** but not later than the prescribed timeframe.

(SEHK Rules 501E(3), 523)

- **Every Exchange Participant** should review both sales and purchases journals at the end of each trading session. Any discrepancy, erroneous transaction or complaint should be reported to the Exchange **not later than 15 minutes** after the commencement of Morning Session of the next trading day.

(SEHK Rule 528(1))

Compliance Reminder

✘ Common Deficiencies

- Inadequate details and guidance with respect to the error reporting
- No post-trade review to ensure the manual trades were reported to SEHK within the prescribed timeframe from the time of conclusion

✔ Good practices observed

- Comprehensive policies and procedures must be maintained to ensure the trade errors and discrepancies are reported to the Exchange within the prescribed timeframe.
- Sufficient post-trade review on manual trade reporting should be in place to ensure the recorded are recorded correctly



Manual Trade

Manual Trade Price Rule

Key Information

- Starting from 18 November 2019, the price rule for transactions concluded outside of the OTP-C during the Continuous Trading Session (CTS) by two different Exchange Participants (EPs) (“i.e. manual non-direct business transactions”) would be aligned with that for direct business transactions.
- Under the *SEHK Rules 518A, 526(3)*, the price of every **manual non-direct business transaction** and **manual direct business transaction** concluded during the CTS **must be within the range** of:

Lowest of

- Twenty-four spreads below the previous closing price;
- The lowest bid price up to the time of the transaction on the day and;
- The lowest ask price up to the time of the transaction on the day

Highest of

- Twenty-four spreads above the previous closing price;
- The highest bid price up to the time of the transaction on the day and;
- The highest ask price up to the time of the transaction on the day



Manual Trade

Period during which input of manual trade is allowed

| | | Applicable Securities | Input Period |
|-----------------------------------|--------------------------|---|--|
| Auction Session | Pre-opening Session | Pre-opening Session Securities only | 09:00 to random matching between 09:20 and 09:22 |
| Continuous Trading Session | Morning Session | All Securities | 09:30 - 12:00 |
| | Extended Morning Session | Extended Trading Securities only | 12:00 – 13:00 |
| | Afternoon Session | All Securities | 13:00 - 16:00 |
| Auction Session | Closing Auction Session | Closing Auction Session Securities only | 16:00 to random closing between 16:08 and 16:10 |



Q & A Session



2021 Priority Areas

Risk Management



Risk Management Areas of Clearing Business



Risk Management

List of Enforcement Focus

- 1 **Stress Testing**
- 2 **Credit Exposure and Position Management (including Capital Based Position Limit)**
- 3 **Settlement Control and Monitoring**
- 4 **Notification of Change in Operations and Risk Control Plan**
- 5 **Non-Clearing Participant Management (for General Clearing Participant)**
- 6 **Risk Governance and Operational Capability**
- 7 **Third party service management and Continuous ability to meet settlement obligations**
- 8 **Operational Resilience**



Risk Management

Stress Testing

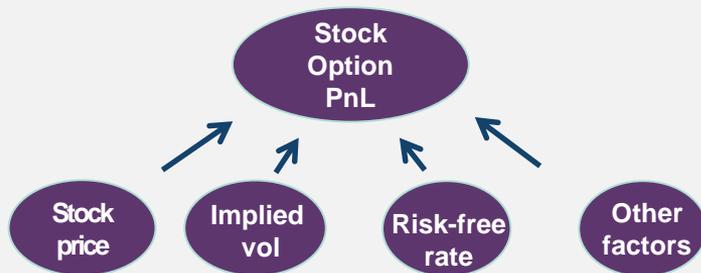
Key Information

Stress Testing of **non-linear products** (eg. options) is crucial since the losses of non-linear products increase exponentially under extreme scenarios.

Linear Products



Non-linear Products



Compliance Reminder

CPs are required to have **proper stress testing** for its own or clients' exposure on HKEX's products, especially on **non-linear products**

CPs are expected to implement and conduct stress testing regularly and at least on a **weekly basis**, to evaluate the maximum potential loss under extreme but plausible market conditions (e.g. +/- 20% and +/- 22% of market movement for index futures and stock options).

Proper stress testing policies and procedures should clearly set out:

- ✓ Methodology
- ✓ Frequency
- ✓ Review and escalation mechanism



Risk Management

Credit Exposure and Position Management (including Capital Based Position Limit)

Key Information

Client limits (e.g. position limits, credit limits and/or trading limits) are imposed by CPs on their clients for controlling their client exposure.

CPs shall implement appropriate and adequate monitoring arrangements, which include inputting the limits assigned to clients into the system for continuous monitoring.

Compliance Reminder

Lack of sufficient and effective monitoring and control on credit exposures

Common deficiencies

- ✘ CPs had not implemented any system to monitor their clients' positions against limits for their clients
- ✘ CPs had allowed clients to transact above the predefined limits and based on their clients' available fund instead
- ✘ Policies and procedures in relation to the treatment of outstanding loan payments were inadequate, where follow-up, escalation and provisioning/ write-off of such loans were not clearly set out
- ✘ Client limits, once granted, were not subject to regular review.



Risk Management

Settlement Control and Monitoring

Key Information

CPs should put in place adequate and comprehensive **internal controls** and procedures governing the settlement process.

Examples

- ✓ A **checklist** with maker-checker signoff over key settlement steps
- ✓ A **system dashboard** monitoring the timeliness in completing each key settlement steps with automatic escalation alerts

CPs should ensure that their staff has **adequate and up-to-date knowledge** on operational risk and control, payment obligations and the consequences of failure in meeting the obligations of the Clearing Houses.

Compliance Reminder

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

Common deficiencies

- ✗ **Inadequate holiday backup arrangement of settlement and accounting officers**
- ✗ **Insufficient e-banking authorization**
- ✗ **Insufficient contingency funding channels (e.g. buffer, overdraft lines and FX facility)**
- ✗ **In review of funding sufficiency**

CPs rely on **internal position data** (instead of Clearing Houses' data/report) during the funding forecast/ arrangement process



CPs may **fail to capture errors** caused by internal system or manual process (eg. incorrect/ incomplete positions net-down in HKCC/ SEOCH)



Incorrect forecast of the settlement amount and may result in payment failure



Risk Management

Notification of Change in Operations and Risk Control Plan

Key Information

CPs should **notify** the Clearing Houses of any change in the details supplied at the time of admission

Examples

- ✓ **Updated** risk and control documents when engaging in **new business activities** such as proprietary trading, stock lending, China Connect market and margin financing

For filings of new business activities, information should be submitted to ClearingCreditRisk@HKEX.COM.HK. Please refer to Circular MSM/001/2021 issued on 19 Feb 2021 for details.

Compliance Reminder

Failure to notify the Clearing Houses when there is a **change** in operations and risk control



Risk Management

Non-Clearing Participant Management (for General Clearing Participant)

Key Information

General Clearing Participant (“GCP”) should **implement** control to manage its relations with Non-Clearing Participant (“NCP”), which includes:-

- ✓ **NCP on-boarding and termination** – on-boarding requirement and obligation/process for NCP termination
- ✓ **Trading/credit risk control and mitigation** – pre-trade and at-trade limit control, trading activity monitoring and exception authorisation
- ✓ **Default management** – NCP default and position close-out process
- ✓ **Day-to-day reporting and settlement operation** – Third-party clearing service related report, process and system (including backup systems)



Risk Management

Risk Governance and Operational Capability

Key Information

CPs should impose a **proper risk governance framework**, which includes establishment of a **risk management committee** for exercising senior management oversight over key risk areas, including

- ✓ Treatment of credit risk
- ✓ Control of concentration risk
- ✓ Monitoring of sufficiency of liquid capital

Compliance Reminder

Inadequate controls in relation to **Risk Management Governance**

Common deficiencies

- ✗ CPs did not keep proper meeting records/reports

Risk Management

Third party service management

Key Information

CPs should establish **proper review and testing procedures** in relation to **system changes** (e.g. system changes that has impact on settlement and margin calculation), which includes

- ✓ Thorough user acceptance testing and
- ✓ Parallel run

Compliance Reminder

Inadequate controls in relation to **system changes**

Common deficiencies

- ✗ Logic error during critical system enhancement made by third party system providers

Continuous ability to meet settlement obligations

Key Information

CPs should develop and maintain a plan to cope with disruptions that may impair CPs' ability to meet settlement obligations

Compliance Reminder

Inadequate arrangement in place to ensure its fulfillment of the Clearing Houses' **settlement obligations especially in the event of a wide-scale or major disruption**



Risk Management

Operational Resilience

The ability of firms – *our participants*, financial market infrastructures (FMIs) – e.g. *HKEX*, and the financial sector as a whole to prevent, respond to, recover and learn from operational disruptions.

Key Information

Operational Risk:

CPs should have documented **operational risk management processes** in place with adequate awareness training to manage operational risk including process, technology and information security risks:

- ✓ Set risk appetite for core business and operations
- ✓ Reduce the likelihood of operational incidents
- ✓ Limit losses in event of business disruption
- ✓ On-going monitoring of emerging risks

Incident Management and Business Continuity:

CPs should have documented **incident management processes**, **business continuity plans** and **disaster recovery plans**, with adequate training and drills to proactively ensure response and recovery capability in the event of business disruptions, including those caused by cyber attacks. Moreover, CPs should promptly report any significant operational incidents to HKEX.

Compliance Reminder

Inadequate operational resilience arrangement may impair CPs' ability to fulfill their **settlement obligations** to the Clearing Houses in case of **operational disruption events**.

Common deficiencies observed:

- ✗ CPs did not have appropriate risk tolerances, risk management framework, monitoring of emerging risks, and/or controls and measures to mitigate cyber risk or to manage manual operation errors, system access controls and system capacity.
- ✗ CPs did not promptly escalate or report significant operational incidents (including material cyber attacks such as ransomware) to HKEX.
- ✗ CPs did not have sufficient planning to manage failure or disruption of critical third party service providers.



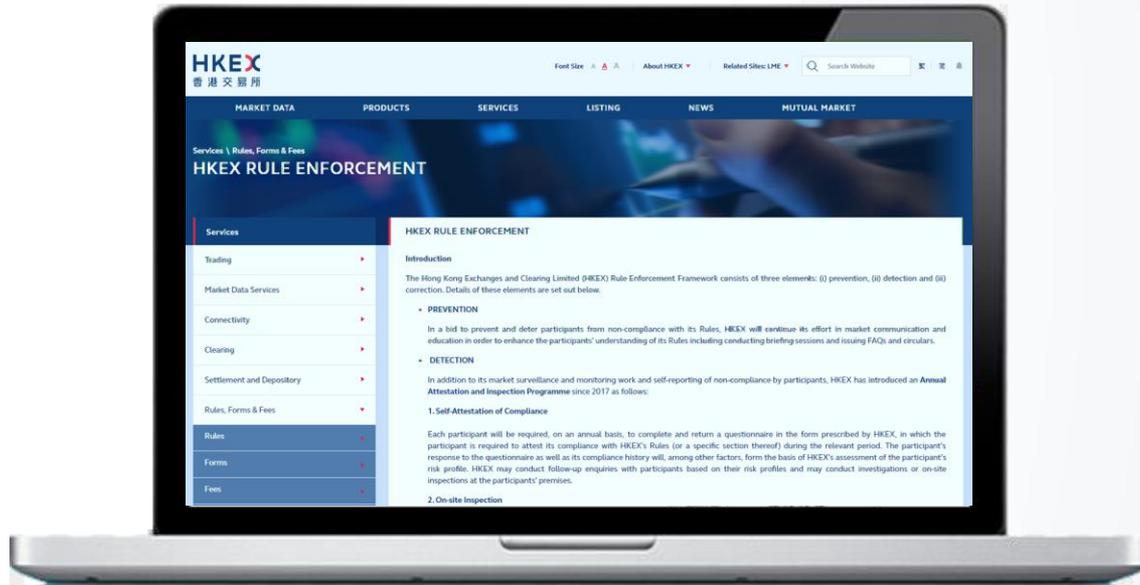
Q & A Session



HKEX Rule Enforcement Designated Website & Email Account



https://www.hkex.com.hk/Services/Rules-and-Forms-and-Fees/HKEX-Rule-Enforcement?sc_lang=en



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