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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 2022 Annual Attestation and Inspection Programme

Enquiry: surveillance@hkex.com.hk

With reference to the circular (Ref. No.: MSM/005/2022) dated 26 April 2022, the Hong Kong Exchanges and Clearing Limited (“**HKEX**”) is pleased to announce that it has successfully completed the 2022 Annual Attestation and Inspection Programme (the “**2022 Programme**”).

Under the 2022 Programme, HKEX inspected 23 Exchange Participants¹ and Clearing Participants² (collectively, the “**Participants**”). HKEX also received 100% response on self-attestation questionnaires from 760 Participants on compliance with the relevant rules and requirements on China Connect Rules, Risk Management and Clearing Rules Obligations (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 Participants were identified.

In summary, a total of 49 Participants were identified with non-compliance issues and/or deficiencies in a number of areas, including:

- Breaches of certain BCAN requirements and investor eligibility requirements;
- Inadequate control arrangements on settlement operations, funding estimation and position management, as well as exposure monitoring and funding arrangement;
- Failure to notify clearing houses of the additional operations and risk control measures associated with new business activities;
- Failure to obtain prior written approval from HKSCC for arranging access to CCASS Terminal from a foreign jurisdiction; and
- Inadequate controls to ensure fulfillment of Clearing Participants’ continuing obligations to timely notify the relevant clearing houses of any changes of their details.

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 initiation 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 of 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 Clearing Rules Obligations¹
(Applicable to Clearing Participants² only)

Clearing Participants (“**CPs**”) of HKSCC, HKCC and SEOCH (collectively, the “**Clearing Houses**”), are required to at all times, comply with the relevant clearing rules obligations as stipulated in the rules and procedures of the respective Clearing Houses³.

In the 2022 Annual Attestation and Inspection Programme, some CPs were found to be deficient in the following areas:-

1. Continuing Obligations

▪ ***Inadequate controls to ensure change of details are timely reported to HKEX***

The continuing obligations require applicable CPs to, amongst other things, notify the respective Clearing Houses of any change of their details under the relevant rules and procedures.

Specifically, it was observed that a number of CCASS Participants have failed to notify HKSCC of any change in the details supplied at the time of admission and thereafter, including but not limited to changes in respect of their Designated Officer and/or Alternate Designated Officer within the specified timeframe.

Under CCASS Rules 1703(iii), each CCASS Participant undertakes that it will notify HKSCC of any change in the details supplied to HKSCC at the time of admission and thereafter, including but not limited to anything relating to such CCASS Participant, its directors or employees which would render inaccurate, incomplete or superseded a statement or information previously furnished by such CCASS Participant to HKSCC.

In addition, CCASS Operational Procedures 2.6 provides that CCASS Participants (other than Corporate Investor Participants) must inform HKSCC in writing of any change of their Designated Officer and/or Alternate Designated Officer and Corporate Investor Participants must inform HKSCC in writing of any change of their Designated Officer by completing and submitting the prescribed form at least three Business Days before the change takes effect.

CPs are reminded to put in place appropriate controls (including adequate policies and procedures and workflow) to ensure that notification of any change of their details is given to HKSCC on a timely basis or within the specified timeframe in the event that such change involves details of their Designated Officer and/or Alternate Designated Officer.

¹ Unless otherwise defined, capitalized terms and abbreviations used in this circular shall have the same meanings as defined in the relevant rules and procedures of the Clearing Houses.

² Referring to (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.

³ Referring to (i) HKSCC: The General Rules of CCASS (“**CCASS Rules**”), the CCASS Operational Procedures; (ii) HKCC: The Rules and Procedures of HKCC (“**HKCC Rules**”); and (iii) SEOCH: The Options Clearing Rules of SEOCH (“**SEOCH Rules**”).

For details about the relevant clearing house rules and requirements, please refer to the circulars issued on 1 December 2022, with reference numbers [MSM/011/2022](#), [MSM/012/2022](#) and [MSM/013/2022](#).

2. Access to CCASS Terminal / Installation outside Office Premises or in Foreign Jurisdiction

- ***Access to CCASS terminal from foreign jurisdiction without prior approval from HKSCC***

Some incidents were noted where the CPs have failed to obtain prior written approval from HKSCC under CCASS Rules for the access to CCASS via CCASS Terminals and Participant Gateways installed in a foreign jurisdiction.

CCASS Rules 704 and 3901 to 3904 respectively specify that unless the prior written approval of HKSCC is obtained, CCASS Terminals and Participant Gateways can only be installed at the office premises of a CCASS Participant or its Settlement Agent. Where a CCASS Terminal is approved to be installed in a foreign jurisdiction or where CCASS is approved to be accessed and operated from a foreign jurisdiction pursuant to Rule 3901, such installation shall be subject to the conditions as stipulated in Rules 3902 to 3904.

CCASS Participants are reminded to confirm that prior written approval from HKSCC is obtained before arranging for installation of CCASS Terminal outside the office premises of a CCASS Participant or its Settlement Agent, or accessing to or conducting activities in CCASS from a foreign jurisdiction.

3. Types of Clearing Accounts in DCASS

- ***Incorrect recording of proprietary positions to Individual Client Account (“ICA”)***

Procedure 1.2.3 under HKCC Rule stipulates, *inter alia*, that an ICA is for the recording, on an individual client basis, of trades and positions of “a client of an HKCC Participant”. A CP was noted to have incorrectly recorded proprietary positions in an ICA for the purpose of segregating its house positions.

HKCC Participants shall ensure that all trades and positions maintained in an ICA belong to one client only and such trades and positions are not held by a client of a HKCC Participant operating an omnibus account.

In this regard, HKCC Participants are reminded to put in place proper controls to ensure compliance with the applicable rules and regulatory requirements.

4. Policies and Procedures

▪ ***Inadequate policies and procedures***

Continuing Obligations. Some CPs have failed to establish adequate written policies and procedures in relation to the notification requirements under CCASS Rules 1703(iii), HKCC Rules 214(n) and SEOCH Rules 403 (17), including but not limited to timely notification of changes in respect of:

- Their Designated Officer and/or Alternate Designated Officer within the specified timeframe;
- Their key contact persons for daily operations (i.e. Margin Call and Money Settlement, DCASS Operations Day / Night and DCASS IT Day / Night); and/or
- Their updated risk and control documents when engaging in new business activities such as proprietary trading, stock lending, China Connect market and margin financing.

Non-comprehensive policies and procedures may pose compliance risk as well as operational risk on the participants. CPs are reminded of the need to establish and maintain comprehensive policies and procedures to ensure compliance with all relevant rules and requirements. In addition, regular review and revision should be conducted to ensure they are consistent, effective and up-to-date.

CPs should also notify the respective clearing houses in case of any violations of the clearing rules, or any of the conditions in any approval given by the respective clearing houses.

5. Staff Training

- ***Inadequate staff training.*** Some CPs did not provide adequate training to the relevant staff in respect of the continuing clearing rules obligations on a regular basis, but merely relied on on-the-job training through sharing and coaching by senior staff members.

To foster a culture of compliance, CPs are reminded that they should provide their staff members with adequate and appropriate training both initially and on an on-going basis.

Appendix 2

Compliance Reminder on Risk Management *(Applicable to Clearing Participants¹ 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 2022 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](#).

¹ (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 and Position Management

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

Risk 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 or CP's own 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 the 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 (i) 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 and (ii) ensuring the monitoring arrangement is capable of timely identifying the heightened risk (e.g. intraday position monitoring is expected to ensure compliance with the Capital Based Position Limits). 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 application 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 size², 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.

² 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) sufficiency of liquidity buffer and 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 (e.g. the updated requirement subsequent to the launch of VaR Platform and derivatives holiday trading in 2022).

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 and make reference to circulars such as “*Reminder on Payment Obligations of Clearing Participants*” issued by the Clearing Houses on 5 December 2022 (Ref. No. [CD/CDCRM/300/2022](#), [CD/CDCRM/301/2022](#) and [CD/CDCRM/303/2022](#)), 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. Drawing from the industry's experience in handling 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.

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 2022 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, 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 one case, a client has been assigned with two BCANs as the system failed to remove the client’s BCAN from the BCAN-CID mapping file when the account was closed, but assigned with a new BCAN when the CCEP subsequently reopened the account of the same client. In another case, a client was assigned with multiple BCANs at the trust level with the same CID of the trustee but the client is in fact the trustee. There were also other scenarios where we noted that testing accounts were incorrectly created for the CCEP itself and/or its clients.
- (ii) Misinterpretation of rules resulted in assignment of different BCANs to
 - clients with multiple accounts such as cash and margin accounts; and
 - fund and fund manager accounts.

▪ ***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 mistakenly assigned their affiliates’ house account under *Legal Entity – Fund managers and others* (Type 4), which is in fact only intended for fund managers or other corporate clients.

- (iii) Due to human errors and the absence of maker-checker process for creating client profile in their internal systems, some CCEPs mistakenly assigned corporate clients/joint account holders under *Individual* (Type 1) which is in fact only intended for individual clients.
 - (iv) 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).
 - (v) Due to misunderstanding of the BCAN-CID mapping data submission requirements, clerical mistakes, staff oversight and/or system error, some CCEPs failed to provide the exact CID as shown on clients' official identity documents, including but not limited to the client name, identity number, ID type, country/region of issuance. In addition, some CCEPs incorrectly used the Business Registration Certificate as identity documents instead of the Certificate of Incorporation or other official incorporation documents / Legal Entities Identifiers (LEI).
 - (vi) 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 BCAN-CID Mapping File data accuracy***
 - (i) ***No regular review.*** Some CCEPs did not conduct any regular review of the data in the BCAN-CID Mapping File and failed to detect inaccurate client type assignments and/or incorrect CID input.
 - (ii) ***Lack of adequate control over data accuracy regarding BCAN assigned by its affiliate to underlying clients.*** Some CCEPs on-boarded their non-EP affiliates as their clients where BCANs were assigned to the affiliates' underlying clients. However, they did not put in place adequate control to ensure data accuracy on those BCANs concerned, leaving the data inaccuracy issue at the affiliates level undetected.
 - ***Insufficient controls / arrangements to ensure BCAN confidentiality and BCAN access granted on a need-to-know basis only***

Some CCEPs displayed the BCANs in their internal systems and/or unnecessarily granted BCAN access to dealers without proper or adequate justifications provided. These CCEPs are considered failing 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 and implementing new booking flow in the order system 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.
- (ii) Some CCEPs mistakenly placed an order originated from one client (client A) to another client (client B) due to the miscommunication between CCEP's sales and trading departments.
- (iii) Incorrect BCAN mapping in the system also led to wrong BCAN tagging.

▪ ***Incorrect BCAN assignment for TTEP***

A single BCAN was assigned to a TTEP instead of a BCAN range. 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.

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 a BCAN was assigned to a client, it shall not be changed and shall not be reused for other clients, unless with the prior written approval from the Exchange. Comprehensive guidelines should be in place to ensure that the controls and arrangements are being implemented as designed and in a consistent manner. 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 review on all data in the BCAN-CID Mapping File, including but not limited to changes (e.g. addition/deletion/amendment) and timely reconciliation between internal system records and the BCAN-CID mapping file to ensure the 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 our 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

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

▪ 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 \("Stock Connect FAQ"\)](#), EPs who are not registered as CCEPs but wish to provide services to their clients to trade in China Connect Securities may do so through CCEPs for the account of their clients as TTEPs.
- (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 the SEHK Rules as if they were CCEPs. From time to time, the Exchange may publish on the HKEX website (or by such other means as it considers appropriate), a list of TTEPs who have submitted declarations to the Exchange. TTEPs must not provide instructions to a CCEP, whether directly or indirectly, to trade in China Connect Securities for the account of their clients before their names are included in such published list of TTEPs.
- (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. Trading of ChiNext and STAR Shares

- ***Inadequate communication of regulatory requirements and prior arrangement***

Some CCEPs failed to communicate with their clients the investor eligibility requirements for trading ChiNext and STAR shares, and the unwinding arrangement upon identification of ineligible transactions in the client agreement.

- ***Inadequate controls to ensure only Institutional Professional Investors ("IPIs") are allowed to trade ChiNext and STAR shares***

Some CCEPs failed to implement pre-trade controls (e.g. identifying ChiNext and STAR shares by complete stock code ranges) to block non-IPIs from trading ChiNext and STAR shares due to a lack of procedures governing timely update of stock code range.

- ***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.
 - (iii) Some CCEPs only sought negative confirmation from intermediaries which have conducted trading of ChiNext and STAR shares. In the event that the intermediaries mistakenly placed orders for ChiNext and STAR shares on behalf of their clients who are not IPs, such breach of the investor eligibility requirement would likely be left undetected.

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

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

EPs are also encouraged to make reference to our 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.

4. Client Agreement and Risk Disclosure

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

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

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

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

We noted that some CCEPs, which provide Margin Trading, Stock Borrowing and Lending and Short Selling services for local securities but not for China Connect Securities, failed to clearly communicate to their clients through the client agreement or other supplementary notification specifying that such services are not available for China Connect Securities.

To comply with the requirements under SEHK Rules 14A10, 14B10, 14A06(13) to (15) and 14B06(16) to (18), and also paragraphs 1.26 and 1.53 of the Stock Connect FAQs, CCEPs and TTEPs should include in the client agreement sufficient provisions covering Northbound trading of China Connect Securities, including the risks involved, and clearly communicate the scope of services provided to clients.

5. Error trade reporting

- ***Misunderstanding of error trade reporting requirement***

Some CCEPs conducted non-trade transfers to rectify error trades but failed to submit error trade report to the Exchange.

Pursuant to SEHK Rule 14A12(3) and 14B12(3), CCEPs who carry out non-trade transfers of China Connect Securities referred to in Rule 14A12(2)(b) or 14B12(2)(b) for the purpose of rectifying an error trade shall submit to the Exchange an error trade report together with supporting documents explaining the nature of the error, how the error was made and providing details of the non-trade transfer to be processed.

6. Policies and Procedures

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

- (i) ***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.
- (ii) ***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.

- (iii) ***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.

7. 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.