ASIFMA Response to SFC Consultation on Investor Identification and OTC Securities Transactions Reporting Regimes

12 March 2021

We refer to the consultation paper regarding proposals to (1) implement an investor identification regime at trading level for the securities market in Hong Kong ("**Hong Kong Investor Identification Regime**") and (2) introduce an over-the-counter securities transactions reporting regime for shares listed on the Stock Exchange of Hong Kong ("**OTC Securities Transactions Reporting Regime**"); as issued by the Securities and Futures Commission ("**SFC**") in December 2020 ("**Consultation Paper**").
We welcome the opportunity to respond to the Consultation Paper and provide feedback by reference to the practical experience of market participants in the financial industry.

We would also like to take this opportunity to express our appreciation that the SFC met with representatives of Asia Securities Industry and Financial Markets Association ("**ASIFMA**"), some member firms and Simmons & Simmons on 4 February 2021 ("**Meeting**") at which we had a useful discussion regarding which persons should be treated as a "direct client" for the purposes of the Hong Kong Investor Identification Regime and the scope of the OTC Securities Transactions Reporting Regime, and that the SFC agreed to grant an extension for us to submit the responses to the Consultation Paper on 12 March 2021.

This response has been prepared by ASIFMA on behalf of our members, with the assistance of Simmons & Simmons. ASIFMA is an independent, regional trade association with over 140 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, accounting and law firms, and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region's economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region.

Unless otherwise defined, all capitalised terms used in this response letter shall have the same meaning as defined in the Consultation Paper.

If you have any queries on this response, please do not hesitate to contact Patrick Pang, Managing Director – Head of Compliance and Tax (+862 2531 6520; ppang@asifma.org).

We confirm that the SFC may disclose the identity of ASIFMA to the public and publish the contents of this response on the SFC website or in any other document to be published by the SFC.

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Our response to questions in the Consultation Paper

(A) A proposal to implement the Hong Kong Investor Identification Regime

Parties and securities for which trade orders and reporting are subject to the proposed regime

Q1:	***Do you have any comments on the coverage of the proposed regime? Apart from the odd lot and special lot market, are there any other types of trades that should be excluded? Please explain your view.***

Our response:

Introduction

1.1 We believe that the Hong Kong Investor Identification Regime which, if successfully implemented, will significantly enhance the SFC's and the Stock Exchange of Hong Kong's ("**SEHK**") ability to conduct market surveillance and detect market manipulation activities.

1.2 Before we provide specific comments on the coverage of the proposed Hong Kong Investor Identification Regime (and in Part B of the responses, the OTC Securities Transactions Reporting Regime), we would like to highlight one of the key areas which our members have requested the SFC to consider when implementing the Hong Kong Investor Identification Regime. This relates to the protection of sensitive personal information data and transaction information.

Protection of Sensitive Personal Information Data and Transaction Information

1.3 Despite the large amount of sensitive personal data and transaction information that will be stored in the central data repository – which will only increase over time – and the associated data protection concerns, the Consultation Paper contains few details regarding data security and protection. It is also unclear from the Consultation Paper: (i) as to how long the SFC and the SEHK intend to retain such sensitive personal data and transaction information; and (ii) whether such data may be transferred to other law enforcement agencies in Hong Kong (based on the drafting of the Consultation Paper, we believe the data will stay in Hong Kong; however, to offer reassurance to Hong Kong and overseas investors, we recommend the SFC to make this point explicit). As the SFC appreciates, collecting information of this nature creates a tremendous risk in the event of a cyber incident and/or a data security breach.

1.4 Based on clarifications from the SFC at the Meeting, we understand that it is not appropriate to draw analogies with the cyber incidents which occurred when hackers attacked the Hong Kong Exchanges and Clearing Limited's ("**HKEx**") website which hosts corporate announcements, as the key distinguishing factor of the Hong Kong Investor Identification Regime is that all submission of CID to the SEHK will be conducted through SEHK's ***closed network*** (our emphasis added) which is protected by secure file transfer protocol. Paragraphs 64 and 65 of the Consultation Paper have further highlighted some of the proposals which the SEHK and the SFC propose to put in place to protect sensitive personal data and transaction information. Whilst we agree that it is more difficult to hack a closed network, we respectfully draw the SFC's attention to Stuxnet[1], a computer worm that is capable of attacking closed network and

[1] https://www.mcafee.com/enterprise/en-in/security-awareness/ransomware/what-is-stuxnet.html

crippling hardware. Stuxnet lives on in other malware attacks based on the original code and the most recent attack was made known to the public in 2018. As of the date of this response, Stuxnet-based malware attacks target a range of critical industries, including power production, electrical grids and defence but in our view, investors (and in particular, sophisticated investors) expect regulators to address cyber security threats to a closed network in a public and transparent manner. This is backed up by views of cyber security experts, who all concur that virus makers' goals and motives have evolved since Stuxnet. These could include extortion, ransomware or if the institution in question refuses to pay ransom, publishing all sensitive data in the public domain.

1.5 We appreciate the efforts which the SFC and the SEHK are prepared to undertake in order to protect sensitive personal data and transaction information. However, in addition to observations set out in paragraph 1.4, we respectfully submit that:

(A) as the introduction of the Hong Kong Investor Identification Regime represents a major and significant change from the current trading environment in Hong Kong; and

(B) global institutional and individual investors are becoming increasingly sensitive over the use, storage and transfer of their personal data and in some cases, confidentiality of their highly proprietary trading strategies,

in order to maintain Hong Kong's status as one of the leading financial centres, as well as Hong Kong and overseas investors' confidence in trading securities and other financial instruments on the SEHK, it is incumbent upon the SFC and the SEHK to ensure that security standards relating to the secure file transfer protocol, encryption methods and the central data repository are clearly enunciated, established and implemented.

1.6 The SFC requested us during the Meeting to provide examples of the information which regulators from major financial centres have made available to the public in relation to security requirements applicable to a central data repository. In this regard, we would like to draw the SFC's attention to Section 4 of Appendix D to the U.S. Consolidated Audit Trail National Market System plan ("**CAT NMS Plan**")[2].

1.7 We are aware that there is at least one critical difference between the CAT NMS Plan and the Hong Kong Investor Identification Regime: under the U.S. CAT NMS Plan, 24 self-regulatory organisations have the ability to bulk download and store all the data stored in the U.S. Consolidated Audit Trail whereas in Hong Kong, it is proposed that the SFC, the SEHK and other law enforcement agencies will have access.

1.8 Section 4 of Appendix D of the CAT NMS Plan sets out the solutions and controls that must be put in place to ensure the security and confidentiality of Consolidated Audit Trail data. These include connectivity and data transfer (Section 4.1.1), data encryption, (Section 4.1.2), data storage and environment (Section 4.1.3), data access (Section 4.1.4), breach management (Section 4.1.5), PII data requirements (Section 4.1.6) and industry standards (Section 4.2).

[2] http://www.smallake.kr/wp-content/uploads/2017/03/CAT-NMS-Plan-Processor-Requirements.pdf

1.9 The U.S. Securities and Exchange Commission ("**SEC**") published, on 21 August 2020, a consultation paper entitled "Proposed Amendments to the National Market System Plan Governing the Consolidated Audit Trail to Enhance Data Security" with a number of significant proposed amendments which are designed to enhance the security of the Consolidated Audit Trail[3].

1.10 To sum up, we respectfully request the SFC and the HKEx to provide much more transparent information on policies and procedures which they propose to put in place to protect sensitive personal information data and transaction information. Whilst it is not a "like-to-like" comparison between the Hong Kong Investor Identification Regime and the U.S. Consolidated Audit Trail, the SEC has demonstrated its willingness to address the importance of data security which investors now attach to their data. Furthermore, if the SFC is minded to publish more transparent information, after which cyber security experts propose to make certain enhancement, we respectfully request the SFC to engage with these experts. This is in line with the approach taken by regulators in major markets.

Other Major Observations

1.11 We wish to highlight some of the observations in respect of the proposals relating to the Hong Kong Investor Identification Regime upfront here:

(A) for reasons set out in our responses to question 4 of the Consultation Paper below, we respectfully submit the SFC to consider adopting a proportionate approach in determining the types and amount of sensitive personal data and transaction information which are *actually* required for the purposes of achieving the overriding objectives of the Hong Kong Investor Identification Regime; and

(B) for reasons set out in our responses to question 2 of the Consultation Paper, we have a number of critical questions regarding whether it is possible to amend BCANs, the rationale for keeping BCANs "strictly confidential" and who should be the "direct clients" to be assigned with BCANs, amongst others. In respect of the latter, we are thankful for the SFC who is currently working in conjunction with the HKEx to publish an information paper ("**Information Paper**") for market participants. We are submitting the scenarios on which ASIFMA's members have clarifications regarding who should be treated as the "direct clients" together with this.

1.12 We would like to stress that our goals are aligned: we are committed to support the SFC to combat market manipulation, as well as the other goals set out in the Consultation Paper and we share a common goal to protect sensitive personal data and transaction information which are entrusted to us. In order to combat market manipulation, the SFC proposes to use the NB Investor ID Regime as the basis. We appreciate different markets will adopt different approaches on ways to implement investor identification regime. With that said:

(A) given the NB Investor ID Regime is unique to the Shanghai-Hong Kong Stock Connect and the Shenzhen-Hong Kong Stock Connect which not all overseas investors are familiar with (e.g. if they do not, or rarely trade eligible A shares through Stock Connect); and

[3] https://www.sec.gov/rules/proposed/2020/34-89632.pdf

(B) under Section 6(2) of the Securities and Futures Ordinance, the SFC has a statutory duty to ensure that "in pursuing its regulatory objectives and performing its functions, ***it shall have regard to*** the international character of the securities and futures industry and ***the desirability of maintaining the status of Hong Kong as a competitive international financial centre***",

we respectfully submit that if some of the concerns and critical questions which we have raised in the responses are not addressed, this may possibly lead to unintended and, in the worst case scenario, counterproductive consequences. For example:

(i) investors may prefer opening accounts or trading in other Asian markets that impose more relaxed requirements on investor identification or transactions reporting requirements;

(ii) investors may trade SEHK listed and/or traded shares through overseas intermediaries which will not execute trades through their affiliated exchange participants in Hong Kong. This creates an "unlevel playing field" between orders that are routed through affiliates vis-à-vis orders that are routed through non-affiliates which may incentivise the use of "non-affiliates" in order to minimise the impact of the Hong Kong Investor Identification Regime on intermediaries. This may also undermine the overriding SFC's policy objective which is to identify the originators of all orders of shares that are traded on SEHK; and

(iii) investors may choose to obtain exposure to SEHK listed and/or traded shares through over-the-counter derivatives (e.g. equity swaps) instead.

Coverage of the Hong Kong Investor Identification Regime

1.13 There are two questions for the SFC's consideration: (i) whether stock options traded on the SEHK are within the scope of the Hong Kong Investor Identification Regime during the initial phase; and (ii) the practicality of excluding odd lots and special lots from the scope of the Hong Kong Investor Identification Regime. We have also raised other observations under the heading "miscellaneous" below.

1.14 **Stock Options and other Equity Derivatives**: According to paragraph 25 of the Consultation Paper, the SFC's ultimate aim is to extend the Hong Kong Investor Identification Regime to ***exchange-traded derivatives market at a later stage*** (our emphasis added). In footnote 19, the SFC clarifies that "this refers to the derivative products traded on the trading system of the Hong Kong Futures Exchange Limited ("**HKFE**")".

1.15 Currently, single name stock options are traded on the SEHK via HKATS whilst single name futures are traded on the HKFE. Applying the SFC's statement and the footnote as set out in paragraph 1.14 above, our understanding is that the SFC intends to implement the Hong Kong Investor Identification Regime to **all** types of stock options and futures (regardless of whether they are traded on the SEHK or the HKFE) at a later stage (i.e. not upon initial implementation of the Hong Kong Investor Identification Regime). We would be grateful if the SFC could confirm our interpretation.

1.16 If our interpretation is incorrect, we request the SFC to implement the Hong Kong Investor Identification Regime to single name stock options that are traded on the SEHK at a later stage. The primary reason for this request is that most intermediaries manage and operate their cash equities business and their futures and options businesses ("**F&O Business**") under two separate business lines. If the SFC intends to immediately implement the Hong Kong Investor Identification Regime to all types of stock options and futures (regardless of whether they are traded on the SEHK or the HKFE), it is expected that intermediaries will need to devote substantial resources from both the cash equities and the F&O Business lines, which, as the SFC will appreciate, is a significant undertaking and perhaps not completely justifiable from a "cost/benefit" analysis standpoint. Amongst other considerations, intermediaries will need to involve senior management, front line business, operations, IT, legal, compliance, risk and other stakeholders from both the cash equities and F&O Business lines to exercise oversight over and/or to take part in the implementation project over a relatively small subset of exchange-traded derivatives in the initial phase. F&O Business line will need to continue to work on phase two of the implementation.

1.17 In addition, if we were to apply the SFC's interpretation, this may potentially move forward the implementation of the Hong Kong Investor Identification Regime over products that are traded on the HKFE to the initial stage, albeit inadvertently. This is because, generally speaking, clients typically have the flexibility to trade a wide array of exchange-traded derivatives (regardless of whether they are listed on the SEHK or the HKFE) using the same set of documentation. It will therefore be somewhat difficult and cumbersome for intermediaries to "isolate" SEHK traded options from other exchange-traded derivatives and only implement the Hong Kong Investor Identification Regime over SEHK traded options.

1.18 **Odd Lots and Special Lots**: We agree with the SFC's rationale for excluding odd lots and special lots from the Hong Kong Investor Identification Regime. However, from a practical perspective, it may be challenging for intermediaries to carve out tagging BCAN to odd lots and special lots orders. Accordingly, we respectfully request the SFC to provide intermediaries with the flexibility to decide, on a voluntary basis, whether to tag BCAN to odd lots and special lots orders. We would also like to request the SFC to revise the proposed paragraph 5.6 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission ("**Code of Conduct**") to confirm that if intermediaries decide to tag BCAN to odd lots and special lots orders, this will not constitute non-compliance with the Code of Conduct.

1.19 We would also be grateful if the SFC could clarify the following:

(A) if intermediaries trade odd lots and special lots and report them as manual cross trades at the SEHK, whether this will bring such trades in-scope of the Hong Kong Investor Identification Regime. If such trades are in-scope, we recommend the SFC to provide the same flexibility as requested in paragraph 1.18 above; and

(B) if an order will be matched through a basket of board lots, odd lots and special lots, whether it is only necessary to assign BCAN to board lots trades only, assuming the intermediary in question chooses not to assign BCAN to odd lots and special lots.

1.20 **Miscellaneous – Reporting of Manual Trades**: The SFC proposes that for manual trades and share placings, after the implementation of the Hong Kong Investor Identification Regime, it will be necessary for the exchange participants of both the buyer clients and the seller clients to report the trades to the SEHK, as opposed to the current practice whereby only the exchange participants of the seller clients need to report the trades to the SEHK. The SFC is of the view that such change would allow better checks and assist in identifying inaccuracies.

1.21 We note the SFC's rationale for recommending the above changes. However, for any deviance from the current practice where only the exchange participants of the seller clients need to report the trades to the SEHK, intermediaries will need to devote substantial resources and costs to update their operational procedures and upgrade their information technology systems. As such, we respectfully request the SFC to allow the current practice to continue, as the benefits of requiring both sides to report trading information are likely to be minimal. This may not justify the additional costs incurred by intermediaries.

1.22 However, should the SFC decide to go ahead with the dual reporting mechanism, we would be grateful if the SFC could permit the exchange participants of the buyer clients to report on a T+1 basis, in order to allow the exchange participants of both the buyer clients and the seller clients sufficient time to verify and resolve any discrepancies directly amongst themselves, prior to reporting to the SEHK. As noted above, it is expected that intermediaries will need to devote substantial resources and costs to meet the new requirement of dual reporting. Although intermediaries will use reasonable efforts to implement the dual reporting system, it is inevitable that there will be technical glitches, especially during the initial stage of the implementation. If the SFC is not minded to agree with our proposal, we would be grateful if the SFC could provide suggestions regarding how exchange participants might rectify reporting errors, as these manual trades are typically executed within a very tight timeframe.

1.23 **Miscellaneous – Primary and Secondary Capital Market Deals**: As the SFC has noted in paragraph 24 of the Consultation Paper, trades on pre-initial public offering ("**IPO**") trading platforms will also fall within the Hong Kong Investor Identification Regime. These platforms typically handle all IPO subscriptions and the associated follow-on public offerings. Having said that, given that (i) no orders will be executed on the SEHK for primary issuance (as the shares have not yet been listed); and (ii) under the existing HKEx's and SFC's rules and regulations, it is necessary to submit the Hong Kong placee lists for primary deals which will include details of the placees who have been allocated with shares, we request the SFC to confirm whether primary issuances fall within, or outside of, the Hong Kong Investor Identification Regime. If primary issuances fall within the Hong Kong Investor Identification Regime, we request the SFC to provide guidance (for example, by way of FAQs) on how to comply with this requirement.

1.24 In the secondary market, transactions related to sell down and top-ups are usually crossed on-exchange, whereby the placing agent will execute a market cross on behalf of the seller(s) and buyer(s) in one aggregated transaction. We request the SFC to provide further clarification on arrangement of CID submission and associated reporting of these types of secondary transactions (see also the questions which we raise in relation to the reporting of aggregation of orders below).

1.25 **Miscellaneous – Alternative Liquidity Pool Operator**: Paragraph 27 of Schedule 8 of the Code of Conduct requires any operator of alternative liquidity pool to provide the SFC with a report recording the volume of trades conducted by each of the 10 largest users of its alternative liquidity pool on a calendar monthly basis within 10 business days after the end of each calendar month, or as otherwise requested by the SFC. We respectfully submit that as the SFC should have information on the underlying clients which place these orders through BCANs, such requirement to be removed from the Code of Conduct.

1.26 **Miscellaneous – Custodians**: As of the date of this response, the provision of custodian services is not regulated in Hong Kong (although the SFC proposes to introduce a new regulated activity to regulate trustees and custodians of public funds). However, it is common for custodians to register with the SFC to carry out the regulated activity of dealing in securities (Type 1) to support its other business lines (e.g. SBL, as defined in question 7 below and third party clearing). Given that it is primarily the responsibility of executing brokers to comply with the Hong Kong Investor Identification Regime, we request the SFC to confirm that custodians which are also registered with the SFC to carry out the regulated activity of dealing in securities (Type 1) will not be required to comply with the Hong Kong Investor Identification Regime. This is notwithstanding that some executing brokers may outsource clearing and settlement functions to custodians.

BCAN and tagging of securities orders

Q2:	***Do you have any comments or suggestions on the proposed operational arrangements for the assignment and submission of the BCAN? Do you have any comments on whether the same or a different BCAN should be assigned to the same client under the NB Investor ID Regime and the proposed HK Investor ID Regime? Please explain your view.***

Our response:

Overview

2.1 As noted in paragraph 1.11(B) above, we have a number of questions regarding:

(A) whether it is possible to amend BCANs – as the SFC will note below, we respectfully submit there are scenarios where there is a genuine need for intermediaries to amend the BCANs;

(B) which clients are to be assigned with BCANs;

(C) post-trade allocation; and

(D) reporting of aggregated orders.

We understand that the SEHK will provide the format of BCAN, as well as other operational information relating to BCAN as soon as practicable. We would be grateful if the SFC could note that the industry will not be in a position to respond to this question completely until it has all information relating to BCAN. Accordingly, the industry may make further submission regarding the operational aspects once this information is available.

Amendment of BCAN

2.2 The SFC proposes that BCANs already submitted or reported to the SEHK cannot be amended without the SEHK's approval. However, we have identified the following "non-exhaustive" circumstances where intermediaries may need to amend BCANs. We therefore propose that:

(A) intermediaries should be permitted to amend BCANs in certain specific circumstances, to be discussed and agreed between the SFC and intermediaries; and

(B) the SFC and the HKEx should accordingly provide guidance on the circumstances and procedures for intermediaries to amend BCANs and the timeframe it will take to amend BCANs.

2.3 In the meantime, the circumstances where we have identified genuine needs to amend BCAN include:

(A) **error input**: errors and technical glitches will inevitably occur. Therefore, intermediaries should be permitted to amend a BCAN following an error input.

For example, an exchange participant mistakenly overfills a client order. We would be grateful if the SFC could clarify the implications and state explicitly this circumstance should not constitute non-compliance with the Code of Conduct. The SFC and the HKEx should also set out procedures for such exchange participant to move the error fills to its error accounts on T day and to amend the inaccurate BCAN attached to the order. We would like to highlight that the current process of completing error forms for submission to the HKEx for processing is, generally speaking, very manual and time consuming. Accordingly, we would be grateful if the SFC could work with the SEHK to introduce an automated process for correcting trade errors and amending BCANs;

(B) **trade give-up**: it is a relatively common practice for a fund manager to initiate an order on the SEHK and at the same time enter into arrangements with its prime broker(s) to take up the position and issue a swap to the fund upon completion of the trade order. In a more complicated trading strategy, the fund manager may instruct the execution broker to split the order into at least two parts – for example: (i) the fund manager will allocate part of the shares to funds under its management; and (ii) the fund manager will instruct one or more prime brokers to issue swap(s) over the remaining shares. Typically the fund manager will only inform the intermediary of the swap transaction and the allocation arrangement upon completion of the transaction, usually by close of business day. However, depending on the time zone of the fund manager it may be further extended for one to two business days as the parties need time to confirm the allocation details.

For the above trade give-up arrangement, in some situations, some firms will treat the fund manager as the client (and hence assign the BCAN of the fund manager). It is their current practice to disregard the allocation arrangements after the fund manager has executed the transactions. However, in certain situations, some firms will treat the prime broker for the issued swap(s) as the

client (as a beneficial owner of the executed position) and these firms consider it is necessary to amend the BCAN to reflect the difference in beneficial ownership in accordance with its own operational procedures.

Accordingly, the SFC and the HKEx should allow intermediaries which amend BCAN in a trade give up scenario to simply file a notification – as opposed to going through any approval process, which will delay settlement – and reflect this in the Code of Conduct or the Rules of the Exchange. Intermediaries should also be given sufficient time to confirm the details with clients before filing the amendment to BCAN (in particular considering the time zone of the international clients), i.e. T+2 as a minimum.

If the SFC prohibits the amendment of BCAN in the above trade give up scenarios, this will have material ramifications. For example, one group of intermediaries will be "forced" to adopt a practice which will not be in line with the "equivalent desks" in other jurisdictions (e.g. London and New York). In turn, this will make it very difficult for these global financial institutions to run their business operations in a smooth manner which may lead to the unintended consequences, as set out in paragraph 1.12 above.

(C) **clients' review of account structures**: From time to time, some clients may change their account structures and choose to open new accounts with the intermediaries (without changing the ultimate beneficial owners etc). In this scenario, it will be necessary for intermediaries to assign a new BCAN. We respectfully submit that the SFC should permit one-off or infrequent changes in such scenarios without the need to seek prior approval from the SEHK.

2.4 **Rejection of trades**: For the purposes of maintaining a smooth market operation, we strongly urge the SEHK to contact the relevant intermediaries as soon as possible if it has any questions over the BCAN after a trade has been executed. If needed, the SFC and the SEHK should allow intermediaries to amend the BCAN within the T+2 timeframe or longer, depending on the time zone differences of intermediaries and their underlying clients as opposed to rejecting the trades in their entirety.

2.5 **Keeping BCAN confidential and timing for keeping BCAN**: We would appreciate clarification as to the rationale for keeping BCANs strictly confidential. An investor should be entitled to know his/her/its BCAN number. If the SFC's view is that it is critical to keep BCAN confidential (to avoid investors using it to conduct market misconduct activities), then the next question which the SFC must clarify is how long it requires intermediaries to keep investors' BCANs, taking into account the current record retention period under the Securities and Futures (Keeping of Records) Rules is 7 years, with the exception in respect of the records set out in Section 1(d) of the Schedule which is 2 years. However, paragraph 37 of the Consultation Paper contemplates that once a BCAN is assigned to investors, it cannot be changed nor reused for other clients. To take this requirement to the extreme scenario, would the intermediaries be prohibited from assigning the BCAN to a different client after the "original" investor passed away or the investor's account is dormant for more than 7 years?

Assignment of BCAN

2.6 It is of utmost importance for intermediaries to have clarity on which clients are to be assigned with BCANs, particularly in light of the permutations of the ways which clients can choose to open accounts using a variety of structures, cross-border booking models, as well as the ways in which orders in securities can be transmitted (e.g. it is common for securities orders to be routed through a chain of intermediaries and non-regulated intermediaries to Hong Kong intermediaries). We have set out, in a separate deck, the scenarios which we would be grateful for the SFC to clarify who should be treated as the "direct clients" which we understand from the Meeting that the HKEx will include these scenarios, to the extent appropriate, in an Information Paper (which is targeted to be published together with the consultation conclusions on the Consultation Paper).

2.7 We understand that the NB Investor ID Regime contains a requirement that the BCAN in question cannot refer to the internal client/account number. We would be grateful if the SFC could clarify if the Hong Kong Investor Identification Regime will – or will not – contain similar requirement. We respectfully submit that provided that intermediaries put in place measures to ensure that clients cannot be identified by external parties, then it will be helpful if intermediaries can link the BCAN with the client/account number as this will promote operational efficiency.

Post-Trade Allocation

2.8 We would be grateful if the SFC could permit fund managers to maintain the flexibility for post-trade allocation of securities between clients with different BCANs after the Hong Kong Investor Identification Regime comes into effect. This is because pre-trade allocations are not practical and post-trade allocation may be needed where there are errors/small lots and other adjustments which are needed. This will not have any implications on the assignment of BCAN.

2.9 To illustrate, if a fund manager which manages fund A and fund B opens an account with an intermediary and places an order of 2000 shares in a particular security and the order is partially filled (e.g. 1500 shares), the intermediary will report the fund manager's BCAN as it is the fund manager which has opened the account with the intermediary. In this scenario, we would be grateful if the SFC could confirm the intermediary will be permitted to allocate 750 shares to fund A and 750 shares to fund B respectively without making further report to the SEHK.

2.10 We would also like to highlight that if the fund managers decide to enter into a swap trade, the intermediary will also need to report the swap trade to the Hong Kong Trade Repository, together with the LEI of the fund. This will allow the SFC to have visibility of the swap trade and the underlying shares.

Reporting of Aggregated Orders

2.11 We would be grateful if the SFC could provide further clarification on the processes, content and timing of submitting information of each underlying clients of the aggregated orders to the SEHK. We would suggest this reporting to be included as part of the over-the-counter reporting, as opposed to on-exchange reporting within the current timeframe (e.g. 15 minutes).

2.12 As the SFC is aware, trading volume in cash equities typically increase on index rebalancing days and the need to aggregate orders for different clients will also

increase as well. In light of this, we respectfully submit the SFC to allow intermediaries to report the underlying clients on a T+2 basis and that the SFC should also allow intermediaries to delay reporting within a reasonable period, as mandated by the SFC (e.g. if the market is experiencing significant turnover which is way above the average).

2.13 The SFC defines aggregated orders as orders which comprise two or more purchase and/or sell orders of the same security placed by ***different clients***. In light of the SFC's definition, we would be grateful if the SFC could confirm that the requirements will not be applicable to aggregated orders belonging to the same clients (e.g. orders placed by the same clients throughout the trading day and orders placed by the same clients for different funds under their management). In addition, for fund managers which manage multiple funds and/or segregated accounts, we respectfully submit that orders of the same security placed by a fund manager for different funds it manages should not be captured by the definition of "aggregated order" as the client for such orders remains to be the same fund manager if the fund manager chooses to open the accounts in its own name.

2.14 We would be grateful if the SFC could clarify, for aggregated orders, whether it is necessary to submit the average pricing to the SFC.

Miscellaneous

2.15 We would be grateful if the SFC could clarify or provide guidance on the following (as the case may be):

(A) as the BCAN will be linked permanently and exclusively to a direct client (subject to our proposal to the SFC to consider allowing intermediaries to amend BCAN in certain circumstances), whether this means intermediaries will be required to keep sensitive personal information "permanently" in order to avoid the need to generate a new BCAN for a client who closed its account after the implementation of the Hong Kong Investor Identification Regime but is re-onboarded after a long time (e.g. more than 10 years). As the SFC is aware, under data protection principle 2 of the Personal Data (Privacy) Ordinance ("**PDPO**"), a person cannot keep personal data "longer than is necessary for the fulfillment of the purpose (including any directly related purpose) for which the data is or is to be used". We would therefore suggest the SFC to allow the flexibility of assigning more than one BCAN to the same client in limited circumstances, including where an intermediary is re-onboarding a client who closed its account for a long time as described above. In addition to PDPO concerns, we also respectfully submit that intermediaries should be permitted to assign new BCANs to institutional clients who are re-onboarded after a long time.

Collection and submission of the CID

Q3:	***Do you have any comments on the proposed data collection and submission of CID and the proposed requirement to keep the central data repository updated? Please explain your view.***

Our response:

Overview

3.1 As noted in paragraphs 1.4 and 1.5 above, in order to ensure that investors' confidence in the SEHK and the SFC will not be undermined regarding the protection of highly

sensitive information, we respectfully submit that the SEHK and the SFC will need to provide the industry with far more details, including technical details, on how they propose to protect data collected.

3.2 We query whether it is realistic to impose obligations solely upon intermediaries to ensure all CID information always remains up-to-date. Inevitably, especially if you are dealing with overseas clients, they may not be aware of the need to notify intermediaries of any updates of their CID information. In this connection, we propose the SFC to consider allowing intermediaries to obtain undertakings from clients to update any information they have provided to the intermediaries from time to time. This should satisfy the intermediaries' obligation to ensure all CID information remains up-to-date, unless it is obvious to the intermediaries that the client has changed its CID information. If the SFC is not minded to accept this proposal, we would suggest that intermediaries can discharge such obligation by conducting periodic reviews of CID information to ensure the information remains up-to-date, in line with the existing practice under the Hong Kong Monetary Authority's and the SFC's Guidelines on Anti-Money Laundering and Counter-Financing of Terrorism (the "**AML/CFT Guidelines**") which only imposes obligations on financial institutions to undertake reviews of customer due diligence records on a regular basis and/or upon trigger events to ensure such information is up-to-date and to conduct a minimum of an annual review on customers that present high money laundering or terrorist financing risks to ensure the relevant customer due diligence records are up-to-date. To facilitate operational efficiency, we respectfully submit that the SFC should consider permitting intermediaries to conduct reviews at such frequency to match with the KYC renewal cycle as required by the AML/CFT Guidelines. Please also refer to paragraph 3.3(F) below.

3.3 We would be grateful if the SFC could clarify, confirm or take into account the following observations (as the case may be):

(A) **verification of CID information**: according to paragraph 5.6(j) of the proposed amendments to the Code of Conduct, an intermediary needs to ensure that all information including CID that it submits is "accurate and free of errors". We would be grateful if the SFC could provide guidance whether intermediaries have the obligation to verify the CID that they receive from their clients; if so, we respectfully submit that such obligation could be discharged by intermediaries obtaining representations and warranties from their clients that the CID they provide from time to time is accurate and free of errors. Otherwise, it would be challenging for intermediaries to discharge the verification obligation for compliance with the Code of Conduct;

(B) **custodians' responsibility**: as noted in paragraph 1.26 above, it is the custodian's executing broker's primary responsibility to, amongst others, collect and submit CID. We would be grateful if the SFC could confirm whether a custodian (even if it is registered with the SFC to carry out the regulated activity of dealing in securities) will be responsible for collecting and submitting CID to the central data repository;

(C) **collection of CID for new clients**: in respect of collection of CID from new clients after the launch of the Hong Kong Investor Identification Regime, we consider that generally a requirement for submission of their CID on the T day

could be feasible. However, in cases where new clients wish to trade on the day of account opening, we respectfully request the SFC to introduce mechanisms which will permit intermediaries to assign new BCAN to clients on the T day and to allow a grace period for intermediaries to submit CID on a retrospective basis (upon a reasonable timeframe) for urgent trades (assuming the intermediaries are able to comply with the customer due diligence requirements set out in Schedule 2 of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance and the AML/CFT Guidelines);

(D) **types of CID information for individual clients**: under the NB Investor ID Regime, as part of the CID submission to SEHK, intermediaries are required to provide Chinese name of a client, if available. In view of the nature and much broader scope of the Hong Kong Investor Identification Regime, we respectfully submit to the SFC to accept the submission of English names of clients, even if the clients also have Chinese names, the purpose being to ease administrative burden;

(E) **types of CID information for individual clients (cont'd)**: paragraph 51 of the Consultation Paper states that Hong Kong residents will need to provide their HKID card information but not their passport details. However, the AML/CFT Guidelines allow the use of passport information for KYC purposes. As such, we respectfully request the SFC to give intermediates the flexibility to rely on individual clients' HKID card information or passport details available on their records;

(F) **update of CID**: the SFC expects intermediaries to submit a new CID file when they are aware of any change to any of CID information, and where the orders are placed by affiliates of exchange participants which execute that orders, such exchange participants are responsible for ensuring that the affiliates provide them with updated CID information. However, based on the industry's experience under the NB Investor ID Regime, intermediaries have been struggling with keeping information of some of their clients up-to-date – for example, some fund managers or funds undergo restructuring from time to time, and there could be difficulties for exchange participants to proactively keep track of any changes to clients' CID information. In light of the relatively onerous obligation to be imposed on intermediaries under the proposed amendments to the Code of Conduct to ensure that the CID it submits to the SEHK are "accurate and free of errors", we respectfully submit that it would be reasonable to submit any updated CID as and when the clients execute the next trade. In this connection, we also submit that it is practically difficult, if not impossible, for exchange participants to ensure that their affiliates inform them of any update to their clients' CID. We would appreciate if the SFC could clarify to what extent exchange participants should be held responsible if their affiliates fail to notify or delay in notifying the exchange participants of updates of CID. As mentioned in paragraph 3.2 above, in our view, exchange participants or their affiliates should not be held liable for any failure to update their clients' CID provided that they obtain appropriate representations or undertakings from clients or carry out refresh of CID exercise in the same timeframe as prescribed by the AML/CFT Guidelines;

(G) **mechanism for submission of CID**: first of all, we would be grateful if the SFC could clarify which software and system it will use to carry out sharing of files and the level of encryption and protection that will be used. In addition, we strongly urge the SFC and the SEHK to provide more information on the system or software to be used for submission of CID and to illustrate how such system or software compares with what is being used internationally for collection and storage of data for investor identification measures. This is because, amongst others, intermediaries may need to put in place specific or additional software or systems to comply with the requirement. Please also refer to our responses to question 4 below. Moreover, we would be grateful if the SEHK could consider providing a feedback and reconciliation mechanism after intermediaries upload the BCAN-CID Mapping File to the SEHK so that intermediaries can ensure that the BCAN submitted is accurate and would not be rejected on the trading day. In addition, whilst we understand from paragraph 48 of the Consultation Paper that the submission of the BCAN-CID Mapping File is generally expected to be a one-off exercise, we suggest that the mechanism should allow the flexibility for submitting CID of existing clients and any other day-on-day changes but not only any incremental or updated CID information;

(H) **validation of CID**: if intermediaries submit BCAN-CID Mapping File on behalf of exchange participants through the Designated Portal, we recommend that the SEHK should send a list of validated BCAN back to the exchange participants for whom such information has been submitted via the Designated Portal, such that the exchange participants can perform BCAN validation at pre-trade level; and

(I) **data confidentiality**: we would also be grateful if the SFC could confirm whether the personal data and transaction information submitted by intermediaries will not be made publicly available.

Data privacy laws and consent from investors

Q4:	***Do you have any comments or suggestions on the proposed measures for Regulated Intermediaries' compliance with relevant data privacy laws and in relation to data security, including the proposed arrangements concerning clients' consent for the handling of their personal data? Please explain your view.***

Our response:

4.1 Given the vast number of clients which would potentially be captured by the Hong Kong Investor Identification Regime and the OTC Securities Transactions Reporting Regime and the short implementation timeframe of the two regimes, we respectfully request the SFC to allow intermediaries relying on the express consent given by their clients under the existing client documentation if the intermediaries consider that such existing consent is sufficient to permit the clients' personal data to be used for the purposes of the two proposed regimes (i.e. the form of consent in existing client documentation should be sufficiently broad to cover the purposes of the use of individual clients' personal data as set out in paragraph 60 of the Consultation Paper). In addition, it has been a long standing practice for intermediaries to determine whether their client agreements, client communication or documentation are sufficient for complying with the requirements under the PDPO, as opposed to being mandated to obtain explicit consent by the SFC.

4.2 We also respectfully request the SFC to introduce a masking relief – at least during the initial stage of the Hong Kong Investor Identification Regime and the OTC Securities Transaction Reporting Regime - to investors currently reside in jurisdictions which may encounter reporting barriers (akin to the ones under Section 26 of the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules). There are currently 18 jurisdictions on the designated list[4]. We are aware that the SFC proposes to publish consultation conclusions to remove these jurisdictions from the designated list (except for the People's Republic of China) but so far we understand that this paper has not yet been published. We appreciate the masking relief was meant to be a temporary measure, but as the Hong Kong Monetary Authority and the SFC pointed out in the joint consultation paper issued in April 2019, it was proposed that the People's Republic of China should remain on the designated list. This will permit reporting entities from the People's Republic of China to continue relying on the masking relief as the Financial Stability Board continues to classify the status of People's Republic of China as "uncertain". This is because it is not clear whether reporting entities from the People's Republic of China will be subject to reporting barriers. We request the SFC to grant masking relief to certain investors under the Hong Kong Investor Identification Regime and the OTC Securities Transaction Reporting Regime. This is because (i) under the OTC reporting regime, the Financial Stability Board and other relevant regulatory bodies regularly co-ordinate the development of regulatory and supervisory regimes across different jurisdictions with an aim to harmonise these regimes to the extent feasible; however, in the context of the Hong Kong Investor Identification Regime and the OTC Securities Transaction Reporting Regime, we do not have an international body which will facilitate such discussion and harmonisation; and (ii) we must avoid a "conflicting" situation where investors are exempted from reporting their OTC transactions to the Hong Kong Trade Repository, but yet are mandated to disclose their personal and transaction information in accordance with the requirements under the Hong Kong Investor Identification Regime and the OTC Securities Transactions Reporting Regime, as these investors may encounter reporting barriers if they disclose their personal and transactional information to Hong Kong.

4.3 If intermediaries conclude that it is necessary to obtain express consent from clients, in light of the practical difficulties of obtaining written consent (partly due to the COVID-19 pandemic), we would be grateful if the SFC could give the industry clear guidance (by way of circulars or FAQs) on the acceptable means to obtain consent by electronic means.

4.4 For corporate clients, we respectfully submit that the requirements under the PDPO will not apply as long as intermediaries will not obtain personal data (as defined under the PDPO) when they assign BCAN and collect CID from corporate clients. For the sake of completeness, we would be grateful if the SFC could confirm there are no other specific consent which the SFC would require intermediaries to obtain from corporate clients.

4.5 If an intermediary concludes that it is necessary to obtain explicit consent from clients, but a client refuses to do so, the intermediary may still assist the clients to dispose their

[4] https://www.sfc.hk/-/media/EN/files/LSD/Gazette/GN-4905-of-2015.pdf

shares. In such scenario, we would be grateful if the SFC could clarify/allocate the BCAN which the intermediary should use in such circumstances.

4.6 We request the SFC to advise what controls the SFC expects intermediaries to implement in order to safeguard data confidentiality for the purposes of the two proposed regimes, in particular any additional measures that are beyond the level of controls the SFC currently expects from the participants of the NB Investor ID Regime. Whilst we appreciate that the SFC's expectations may be similar to the existing controls required in relation to the NB Investor ID Regime, in view of the fact that mainland China and Hong Kong operate different sets of laws and regulations on data privacy, we would welcome the SFC to provide clear guidance specific to the Hong Kong Investor Identification Regime and the OTC Securities Transactions Reporting Regime.

4.7 We would be grateful if the SFC could confirm it will not use personal data to carry out "matching procedures", as defined under the PDPO.

4.8 On a separate note, we understand that the HKEx Group has appointed a Chief Information Security Officer which will be responsible for both protecting HKEx from cyber-attacks and adhering to laws, rules and regulations relating to data privacy. As part of the initiative to enhance data protection and protect the integrity of the personal data, we suggest that the HKEx should consider dividing the function of the Chief Information Security Officer into two separate functions, for cyber security and data privacy respectively.

Proposed amendments to the SFC Code of Conduct

Q5:	***Do you have any comments on the proposed amendments to the SFC Code of Conduct for the purpose of implementing the HK Investor ID Regime? Please explain your view.***

Our response:

5.1 We would be grateful if the SFC and the HKEx could confirm whether there will be separate consultation exercises for the proposed amendments to the Code of Conduct, as a number of market participants take the view that they do not have sufficient time to consider the amendments to the Code of Conduct, and the corresponding changes that need to be made to the Rules of the Exchange. For the latter, as it will set out the trading rules which exchange participants must comply with, we strongly urge the HKEx to launch a public consultation in this regard.

5.2 In addition, any additional guidance which the SFC and the HKEx can release prior to going live will be much appreciated by the industry.

Q6:	***Do you have any comments on the proposed implementation timeline for the HK Investor ID Regime? Please explain your view.***

Our response:

6.1 Given that:

(A) market participants will need to devote significant time to enhance the operational systems, perform client outreach (especially for overseas clients);

(B) the need to consider whether it is necessary to obtain consent from clients relating to the issue on data privacy and if the conclusion is that it is necessary, the time it will take to obtain consent from clients;

(C) many of our members are currently focusing their time and resources to implement system changes and make other arrangements needed for compliance with the SFC's Data Standards for Order Life Cycles (by the end of October 2020 for in-scope brokers, or by April 2021 for other licensed brokers who are not already in-scope but reached the relevant threshold);

(D) the implementation timeline is close to "Project Fini" (i.e. HKEx's proposed introduction of a new IPO settlement platform); and

(E) the need to work with global counterparts to implement certain aspects of the requirements, which overlap with some of the holiday seasons,

we respectfully request the SFC to delay the implementation timeframe to at least 18 months after the requirements have been finalised by the SFC and the SEHK.

6.2 We would also be grateful if the SFC could consider the following:

(A) the SFC may wish to consider a soft-launch period for the market to get familiar with all the requirements;

(B) any reporting requirement (such as aggregation order details, CID information etc) should support bulk uploading by market participants (particularly single reporting template supporting multiple securities and multiple clients, including aggregated orders), so as to promote operational efficiency and reduce the manual input error; and

(C) prior to the launch of the reporting regime, the SFC/SEHK should arrange training sessions and testing environment for users, so as to gather market feedback and to ensure a smooth rollout.

(B) A proposal to introduce the OTC Securities Transactions Reporting Regime

OTC Securities Transactions Reporting Regime

Q7:	***Do you have any comments on the proposed OTC Securities Transactions Reporting Regime? Please explain your view.***

Our responses:

Overview

7.1 We have a number of questions on the scope of the proposed OTC Securities Transactions Reporting Regime, as set out below. We would be grateful if the SFC could provide clarification and guidance. With that said, after our Meeting, we appreciate the SFC is considering revising the language of draft paragraph 5.7 of the Code of Conduct and as a result, a number of the following examples, depending on the revised language, may fall outside the regime.

7.2 **Triggers for Reporting Obligation**: We would appreciate if the SFC can explain the rationale for considering a "transfer of shares" by a regulated intermediary as one of

the activities that trigger obligations under the OTC Securities Transactions Reporting Regime. The current reporting of on-exchange or off-exchange transactions to the SEHK and the reporting regimes in other developed markets are primarily order-centric, however still manage to facilitate effective market surveillance. As such, the SFC might consider removing "share transfer date" from the information to be submitted to the SFC for each share transfer. The SFC may also consider removing withdrawal or deposit of physical share certificate from the reporting obligation under the OTC Securities Transactions Reporting Regime. With such changes, the industry could adopt existing processes, therefore reducing implementation efforts.

7.3 **Payment of Stamp Duty**: We would like the SFC to confirm whether the primary factor in determining whether an OTC Securities Transaction is reportable (with the exception of deposit or withdrawal of physical certificates of shares), it is only necessary to consider whether such transactions are subject to payment of stamp duty. For example, intermediaries will not be required to report intra-group transfer of shares which obtained relief pursuant to Section 45 of the Stamp Duty Ordinance. We would also like the SFC to clarify how should intermediaries treat OTC Securities Transactions which may potentially be excluded from payment of stamp duty, subject to approval by the Inland Revenue Department. For example, whether it is feasible to extend the reporting deadline from T+1 to T+2, pending the Inland Revenue Department's determination on certain transactions.

7.4 **Securities Lending and Borrowing Transactions**: We would like the SFC to clarify whether securities lending and borrowing transactions ("**SBL**"), repurchase transactions ("**repos**") and reverse repurchase transactions ("**reverse repos**") fall outside the OTC Securities Transactions Reporting Regime by virtue of Section 19(11) of the Stamp Duty Ordinance (unless the SBL, repos and reverse repos in question are unable to rely on the relevant exemption). For example, there are certain aspects within SBL, repos and reverse repos which are exempted from stamp duty, including:

(A) "Hong Kong stocks" (as such term is defined under the Stamp Duty Ordinance) can be used as loaned securities and collateral securities in SBL. If Hong Kong stocks are used as collateral, they are typically transferred by way of free of payment to the funding counterparties either bilaterally or through a triparty agent;

(B) intermediaries may from to time transfer Hong Kong stocks by way of free of payment between two accounts held by the same intermediaries which are owned by the same beneficial owners. Applying the example set out in paragraph 87 of the Consultation Paper, such transfer should not fall within the OTC Securities Transactions Reporting Regime; and

(C) Hong Kong stocks can also be used as collateral in non-title transfer funding trades, such as secured notes. The Hong Kong stocks would be pledged as collateral to the funding counterparties in segregated accounts under the name of the intermediaries that own the collateral. There is no title transfer involved and accordingly, there is no stamp duty implication.

7.5 If the SBL, repos and reverse repos in question are unable to rely on the relevant exemption under the Stamp Duty Ordinance, we would like the SFC to clarify the procedures and timeframe for reporting these transactions.

7.6 We would like to the SFC to confirm whether the following transactions, which are subject to payment of stamp duty, are in scope of the OTC Securities Transactions Reporting Regime:

(A) delivery of shares listed on SEHK off the back of a structured product, such as an equity-linked note, an accumulator contract, a convertible bond, a structured note and the exercise of stock option;

(B) transfer of shares on the back of an unqualified stock loan (e.g. arising from transfer of short positions and cash close out of suspended stock by clients); and

(C) where the transfer in Hong Kong stock is arranged by an overseas regulated affiliate without involving the Hong Kong intermediary, and the Hong Kong intermediary is not involved in arranging for the transfer to be stamped, the Hong Kong intermediary will not be required to file any reports under the OTC Securities Transactions Reporting Regime if it subsequently becomes aware of such transfer.

7.7 **Cross Border Issues**: If OTC Securities Transactions relating to Hong Kong stocks are booked overseas (e.g. the stocks and the related transactions are booked to the intermediaries overseas affiliate), Hong Kong intermediaries will interpret the revised Code of Conduct as appropriate in determining whether it will fall within the scope of the OTC Securities Transactions Reporting Regime. For example:

(A) if a trader of a Hong Kong intermediary arranges a client of its overseas affiliate to sell or buy Hong Kong stock by way of an OTC transaction, the Hong Kong intermediary will report these trades. In addition, if a trader of a Hong Kong intermediary arranges, in his/her capacity as a settlement agent, the transfer of shares purchased or sold by a client of its overseas affiliates by way of OTC, the intermediary will also report such trades; and

(B) for reportable cross-border trades, we respectfully submit to the SFC that the timeframe should be extended to T+30 which will match with the timeframe for payment of stamp duty for any sale or purchase of Hong Kong stocks effected outside Hong Kong. We would also like the SFC to include the role "settlement agent" in the report menu as this provides a more accurate description of the Hong Kong intermediaries' role.

7.8 **Cross Border Issues (cont'd)**: On the other hand, intermediaries which are part of global financial institutions may from time to time assist in settling stamp duty incurred by overseas affiliates for trades where the intermediaries have no involvement (e.g. conversion of ADR to local stocks, cross trades by clients of overseas affiliates, redemption of Hong Kong stocks by ETFs listed on overseas exchanges etc). Since such activities do not constitute any "regulated activity" in Hong Kong – but are merely assisting their overseas affiliates in relation to the above, these types of transactions, which are administrative in nature, will not fall within the scope of the OTC Securities Transactions Reporting Regime.

7.9 **Custodians:** As noted in our responses to question 1 above, given it is the executing brokers' responsibilities to submit reports which comply with the OTC Securities Transactions Reporting requirement, we would like to confirm that, custodians are not

required to comply with the OTC Securities Transactions Reporting requirement, subject to the following observations.

7.10 **Custodians (cont'd)**: We would like the SFC to clarify whether custodians will be required to comply with the OTC Securities Transactions Reporting requirement in the following circumstances:

(A) all acquisitions and disposals arising as a result of taking up error positions whilst processing corporate actions. To illustrate by way of example, where a client wishes to obtain cash dividend but the custodian has mistakenly input the instruction as bonus shares, the custodian will take up the error positions in the course of processing the corporate actions and request an exchange participant to sell such shares and such disposal will be executed in the market;

(B) a custodian may not be aware of whether stamp duty is chargeable in the transaction in question. As noted in paragraph 7.9 above, given it is the executing brokers' responsibilities to submit reports which comply with the OTC Securities Transactions Reporting requirement when executing brokers are involved in arranging the transaction (and in fact, some of the brokers have arranged for the payment of stamp duty prior to requesting the custodian to facilitate settlement of transactions), we would like to confirm that it is not the custodian's responsibility to comply with the OTC Securities Transactions Reporting requirement;

(C) similar to the observation raised in paragraph 7.9 above, from time to time, custodians will not act as agent for clients but will only provide administrative service and assist clients to pay stamp duty (i.e. acting as an administrative agent for tax filings). We respectfully submit that in such scenario, it should not be necessary for custodians to comply with the OTC Securities Transactions Reporting Regime as custodians are performing an administrative – rather than a regulated activity;

(D) a custodian may receive instructions from its direct client which is an overseas regulated intermediary to perform certain administrative tasks, such as stock transfer, deposit or withdrawal of physical certificates of shares. Assuming this triggers a reporting obligation (although in our view, as these are administrative tasks, these are unlikely), if the custodians are subject to reporting obligations, we would like to clarify with the SFC whether it is only necessary to provide the CID of the overseas regulated intermediary, as the custodian may not be able to procure the overseas regulated intermediary to collect CID information (this issue is particularly acute in the context of the custody industry, given shares are typically held in central securities depositories and chain of intermediaries, possibly in multiple jurisdictions). Again, assuming this triggers a reporting obligation, we would also be grateful if the SFC could clarify whether the response will be different if the overseas regulated intermediary is an affiliate of the custodian; and

(E) a custodian may need to deposit and withdraw physical certificates as client's agents. We would like the SFC to confirm whether the OTC Securities Transactions Reporting Regime applies in this circumstance.

7.11 **Miscellaneous**: Intermediaries may receive instructions from fund managers to effect share transfer for/across different funds under their management. In this case, we would like to clarify whether the intermediaries should report the fund manager, the funds or depending on the structures, trustees/directors as the transferor/transferee.

7.12 **Reporting Threshold**: Given the volume of off-exchange transactions, we respectfully submit that the SFC set a reporting threshold. If otherwise, all of the intermediaries will need to devote substantial resources to ensure that they collect accurate information and complete filings on a T+1 basis, which as the SFC appreciates, is not practical. We would like to emphasise that we will remain co-operative in providing any information requested by the SFC for OTC Securities Transactions below the reporting threshold.

7.13 **No Additional Reporting for On-Exchange Trades**: We refer to paragraph 91 of the Consultation Paper. From time to time, intermediaries may report the BCAN when the fund manager executes transactions. During the course of settlement or after settlement, the fund managers may direct the intermediaries to settle with different funds. Applying paragraph 91 of the Consultation Paper, we are of the view that it is not necessary for intermediaries to report the transactions again under the OTC Securities Transactions Reporting Regime. However, we would like the SFC to confirm this point.

7.14 We would be grateful if the SFC could take into account the following and expand on the proposed paragraph 5.7 of the Code of Conduct, as appropriate:

(A) transactions in suspended stocks by non-exchange participants or short selling of securities which are carried out on an over-the-counter basis will not fall within the OTC Securities Transactions Reporting Regime, as they are not reportable to the SEHK;

(B) assuming no stamp duty is payable, any movement of underlying shares as a result of (a) the creation and redemption of the depository receipts; or (b) exercise or being exercised of rights and options will not fall within the OTC Securities Transactions Reporting Regime. Specifically, it does not make a difference if the rights/options are listed or traded on the SEHK;

(C) any over-the-counter securities transactions with affiliated entities (excluding asset management and private banking entities) for the purposes of managing internal risk or restructuring of the group will fall within the OTC Securities Transactions Reporting Regime;

(D) given stock transfer between different accounts that are beneficially owned by the same clients will be exempted from the OTC Securities Transactions Reporting Regime, the deposit or withdrawal of physical shares by the same person (i.e. no change in beneficial ownership) will fall within the regime. We would like to highlight that on some occasions, deposit and withdrawal of the physical scrips are merely for the purpose of creating/splitting jumbo certificates, rather than making any changes to beneficial ownerships;

(E) when the buyer and seller have arranged the transactions themselves and we are merely instructed to process stock transfer, we may only receive the

instruction on settlement date. Together with the time to gather relevant information, if there is any reporting requirement of such stock transfer, we would suggest allowing the reporting to be made on the later of (a) settlement/value date + 3 days as a minimum, or (b) 3 days from the time when we are aware of the effected stock transfer (in case if we are only informed of the event after settlement date/value date);

(F) for the purposes of facilitating a clear understanding of the deadline of submission, we would like to clarify the definitions of "transfer /deposit/withdrawal day" in paragraph 84 of the Consultation Paper to refer to either one, or both of the scenarios and specify in the revised paragraph 5.7 of the Code of Conduct accordingly:

(i) "Transfer day" - does it refer to the date when intermediaries receive settlement instructions from client, or the date when intermediaries input or effect the settlement instructions into CCASS/clearing house?

(ii) "Deposit day" - does it refer to the date when intermediaries receive the share certificates from clients, or the date when intermediaries deposit the certificate with CCASS?

(iii) "Withdrawal day"- does it refer to the date when intermediaries receive the withdrawal requests from clients, the date when intermediaries input the instructions to CCASS, the date when intermediaries pick up the certificates from CCASS, or the date when the clients pick up the shares from us; and

(G) the SFC should also consider permitting an offshore entity to authorise the Hong Kong intermediaries to report for and on behalf of the offshore entity directly.

OTC Securities Transactions Reporting Regime submission system

Q8:	***Do you have any comments on the proposed OTC Securities Transactions Reporting Regime submission system? Please explain your view.***

Our response:

8.1 For the reporting of OTC securities transactions in respect of share transfer (not physical share certificate deposit or withdrawal), we would be grateful if the SFC and SEHK would consider enhancing the CCASS system to enable intermediaries to tag CID to an instruction to effect share transfers. In addition, new flag(s) can be added to the instruction (e.g. change in beneficiary flag, stamp duty flag) to enable SEHK to extract the relevant information in an effective manner and share with the SFC for the purpose of surveillance. With this enhancement, the SFC can have access to the relevant information on the date of share transfer (not the following day) and in turn, intermediaries will only have to submit the required information for share transfer and physical certificate deposit or withdrawal that are not processed in CCASS.

8.2 We would also welcome the opportunity to discuss with the SFC on the establishment of a system interface which allows straight-through-processing.

Data privacy and consent from investors

Q9:	***Do you have any comments on the proposed arrangements concerning clients' consent under OTC Securities Transactions Reporting Regime? Please explain your view.***

Our response:

Please refer to our responses to question 4 above.

Proposed amendments to the SFC Code of Conduct

Q10:	***Do you have any comments on the proposed amendments to SFC Code of Conduct? Please explain your view.***

Our response:

Please refer to our responses to question 5 above. In addition, paragraph 5.7(a) of the Code of Conduct provides that intermediaries should refer to the definition of "client" in paragraph 5.6(I)(ii) – the client shall be the person to whom BCAN is assigned for on-exchange orders and off-exchange but reportable orders. In that case, we would be grateful if the SFC could clarify whether intermediaries should refer to Appendix 1 of the Consultation Paper to determine who qualifies as a "relevant client".

For draft paragraph 5.7(h) of the Code of Conduct, the mandatory withdrawal of shares for clients who refuse to grant consent should only apply to individual clients. This will align with draft paragraph 5.6(o)/(p) of the Code of Conduct which mandates intermediaries to sell down the individual clients' shares if they refuse to grant intermediaries the requisite consent.

Implementation timeline

Q11:	***Do you have any comments on the proposed implementation timeline for the OTC Securities Transactions Reporting Regime? Please explain your view.***

Our response:

The proposals require the reporting of information related to the order (e.g. stock name, quantity), settlement (e.g. share transfer date) and/or client static data (CID) to a SFC portal. Considering that it is uncommon to include settlement information as part of the required data, it will normally take an intermediary 18-24 months to put in place process after the system interface specifications become available. Additionally, (i) the definition of who would classify as a "relevant client"; (ii) the type of involvement or touchpoints that trigger reporting obligation for a regulated intermediary; and (iii) the actual reporting mechanism as a result of such involvements, are unclear in the Consultation Paper and we respectfully request the SFC to consider consulting with the industry again when there is further clarity on these topics. We would also appreciate if the SFC can publish FAQs to address industry concerns, and set up an industry working group to discuss the system and interface requirements for the OTC Securities Transactions Reporting Regime.

<u>Other Comments</u>

We would be grateful if the SFC could clarify whether there are any specific record keeping requirements applicable to both the Hong Kong Investor Identification Regime and the OTC Securities Transactions Reporting Regime.