

# Oversight

## SFC Consultation conclusions on investor identification regime and over-the-counter securities transactions reporting regime

August 2021

### Introduction

On 10 August 2021, the Hong Kong Securities and Futures Commission (SFC) published consultation conclusions (Consultation Conclusions) regarding (1) the implementation of an investor identification regime for the securities market in Hong Kong at the trading level (HK Investor ID Regime) for any securities and derivatives listed and/or traded on the Stock Exchange of Hong Kong Limited (SEHK)'s trading system, except (i) securities traded on the odd lot and special lot markets of the SEHK (save for underlying orders in an executed aggregated order) and (ii) transaction(s) reported via the SEHK's trade amendment system (In-Scope Securities); and (2) the introduction of an over-the-counter securities transactions reporting regime for ordinary shares and units in real estate investment trusts (REITs) listed on the SEHK (OTC Securities Transactions Reporting Regime). Derivatives will include callable bull/bear contracts, derivative warrants and inline warrants, but not stock options and futures as these are traded on Hong Kong Futures Automated Trading System. Prior to this, on 4 December 2020 the SFC published a consultation paper regarding the above (Consultation Paper).

The SFC expects to introduce the HK Investor ID Regime by the second half of 2022 and the OTC Securities Transactions Reporting Regime by the first half of 2023. The SFC will add new paragraphs 5.6 and 5.7 to the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (Code of Conduct) respectively. The SFC has included a finalised version of the new paragraphs 5.6 and 5.7 of the Code of Conduct in Appendix C of the Consultation Conclusions.

The purposes of this **Oversight** are to: (i) provide an overview of the SFC's finalised proposals relating to the HK Investor ID Regime and the OTC Securities Transactions Reporting Regime; (ii) outline the steps which relevant licensed corporations and registered institutions (collectively Relevant Regulated Intermediaries) need to take in order to implement the HK Investor ID Regime and the OTC Securities Transactions Reporting Regime; and (iii) highlight some practical considerations for the Relevant Regulated Intermediaries to consider.

In summary, the SFC has made a number of changes to the original proposals in the Consultation Paper. They include:

- scope of "relevant client" and clients of exchange participants' (EP) overseas affiliates: under the original proposal, the SFC proposes to include clients of EP's overseas affiliates as a category of "in-scope" client for the HK Investor ID Regime. However, taking into account the consultation feedback, the SFC has revised the definition of "client" in the Consultation Conclusions and it will no longer involve clients of EP's overseas affiliates; and

- scope of “**Relevant Regulated Intermediaries**”: the SFC clarifies in the Consultation Conclusions that not all licensed corporations and registered institutions will be subject to the HK Investor ID Regime. Instead, it introduces the term “**Relevant Regulated Intermediary**”: which refers to a licensed corporation or a registered institution which (i) carries out proprietary trading; or (ii) provides securities brokerage services for another person in respect of orders placed through an account opened and maintained for that person.

## Current Market Infrastructure and Drivers of the SFC’s Amendments to the Code of Conduct

The existing market infrastructure and the drivers behind the SFC’s amendments to the Code of Conduct are as follows.

With the exception of the investor identification model for trading of eligible shares listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange under the Northbound Stock Connect (NB Investor ID Regime), Relevant Regulated Intermediaries may execute securities transactions:

- on-exchange through the SEHK’s automatic order matching system (On-Exchange Orders);
- off-exchange outside the SEHK’s automatic order matching system (Off-Exchange Trades) where such transactions are required to be reported to the SEHK within the timeframe prescribed under the Rules of the Exchange of the SEHK (OE Trade Reporting); and
- off-exchange outside the SEHK’s automatic order matching system and the consummation of which would result in off-exchange trades (Off-Exchange Orders)

*without the need to disclose the identities of their clients.*

Reportable Off-Exchange Trades may include those manual trades concluded by participants of the SEHK (EPs) or trades matched between clients of platforms operated by Relevant Regulated Intermediaries licensed by or registered with the SFC to conduct the regulated activity of providing “automated trading services” (Type 7).

The Consultation Conclusions capture On-Exchange Orders, Off-Exchange Trades and Off-Exchange Orders. However, in the finalised paragraphs 5.6 and 5.7 of the Code of Conduct, somewhat confusingly, the SFC defines reportable off-exchange transactions as “**Off-Exchange Trades**” which are subject to the OE Trade Reporting requirements (see paragraph 5.6(b)(xiii) of the Code of Conduct). Amendments to the definitions of relevant terms – for example to include “Reportable Off-Exchange Trades” and “Non-Reportable Off-Exchange Trades”, would make the new requirements easier to follow.

The Relevant Regulated Intermediaries may execute the on-exchange and off-exchange transactions by themselves (whether as agents for their underlying clients or as principals) if they are EPs or through other Relevant Regulated Intermediaries that are EPs.

If the SFC detects unusual trading patterns and needs to obtain specific information relating to certain transactions (e.g. if the SFC has identified unusual trading patterns), it will need to issue notices to the EPs under Section 181 of the Securities and Futures Ordinance (SFO). This is commonly known in the market as “**Section 181 Notice**”. The SFC, on average, gives EPs a few business days to respond to its request for information. The SFC points out in the Consultation Paper that it typically takes “two or more rounds” of Section 181 Notices before the SFC is able to obtain the information it needs.

## The SFC's Key Plans in the Consultation Conclusions

With the objectives to:

- improve transparency in respect of investors' identities to facilitate the SFC's market surveillance function;
- enhance the SFC's ability to identify suspicious trading activities;
- reduce compliance costs for both the SFC and the Relevant Regulated Intermediaries; and
- bring Hong Kong in line with a growing trend among regulators globally to develop investor identification requirements to facilitate more effective market surveillance capability,

the SFC will introduce: (i) an investor identification system for any transactions relating to In-Scope Securities; (ii) an OE Trade Reporting requirement for Off-Exchange Trades relating to In-Scope Securities; and (iii) an OTC Securities Transactions Reporting Regime for shares listed on SEHK (i.e. ordinary shares of a company or units of REITs listed on the SEHK). ((i) and (ii) are collectively known as the HK Investor ID Regime).

The SFC will first implement the HK Investor ID Regime in relation to In-Scope Securities with the ultimate aim to extend the regime to exchange-traded derivatives market, such as stock options and futures contracts.

### HK Investor ID Regime

To implement the HK Investor ID Regime at the trading level, the SFC will require a Relevant Regulated Intermediary to adopt at least the following measures:

- assign a “**Broker-to-Client Assigned Number**” (BCAN), a unique identification code, to each of its clients. The SFC defines “**client**” in paragraph 5.6(m) of the Code of Conduct as the direct client of the relevant licensed or registered person, save for certain specified exceptions. The term “**direct client**” is defined in draft paragraph 5.6(b)(v) of the Code of Conduct as the “most immediate client of a relevant licensed or registered person which has placed or proposes to place an on-exchange order or off-exchange order through a securities trading account with that person”. Each BCAN should be able to identify a specific client of the Relevant Regulated Intermediaries, but it should not bear any obvious link to any of their identities. All Relevant Regulated Intermediaries must keep all BCANs confidential. The SEHK will provide more information on the format of the BCAN in due course;
- collect up-to-date client identification data (CID) from each client to whom the Relevant Regulated Intermediaries have assigned a BCAN and prepare a “**BCAN-CID Mapping File**” for submission to the SEHK's data repository;
- include all direct clients' BCANs in the order information for all On-Exchange Orders, OE Trade Reporting and all Off-Exchange Orders; and
- adopt relevant data privacy and security measures to safeguard the personal data collected, transmitted and stored and obtain all direct clients' express consent on, amongst others, purposes of which their personal data may be used and transferred. The SFC states in paragraph 5.6(p) of the Code of Conduct that Relevant Regulated Intermediaries may obtain written or other express consent in a form and manner in compliance with the SFC's requirements. A record of consent must be kept by the relevant licensed or registered person for as long as the client remains its client and up to at least two years after the client relationship ceases. Such consent should be obtained on or before the submission of the BCAN-CID Mapping File in respect of an individual client.

### Implementing the HK Investor ID Regime Step 1: Identify Direct Clients

Applying the above, the first step which all Relevant Regulated Intermediaries will need to carry out is to identify each direct client and assign a BCAN accordingly.

Types of Transactions	Direct Clients
Proprietary traders	<ul style="list-style-type: none"> <li>As no third party client is involved, the proprietary traders should assign BCANs to themselves when they conduct proprietary trading.</li> </ul>
Transactions routed through an intermediating chain of brokers	<ul style="list-style-type: none"> <li>If the orders are routed through an intermediating chain of brokers, the direct clients are the first non-Relevant Regulated Intermediaries.</li> <li>The last Relevant Regulated Intermediary in the chain (starting with the EPs executing the orders and working backwards), whose direct clients are not Relevant Regulated Intermediaries shall be the party responsible for assigning the BCAN, collecting the CID, preparing the BCAN-CID Mapping File and submitting the BCAN-CID Mapping File to the SEHK either directly or indirectly through another Relevant Regulated Intermediaries.</li> <li>Where a Relevant Regulated Intermediary transmits an on-exchange or off-exchange order to another person who is not a Relevant Regulated Intermediary in an intermediating chain of brokers for execution, the Relevant Regulated Intermediary should take reasonable steps (including putting in place arrangements with the receiving person) to ensure that the BCAN (and, in the case of an aggregated order, the specific code prescribed by the SEHK) assigned and tagged to the order by the Relevant Regulated Intermediary would be transmitted by the receiving person to the next Relevant Regulated Intermediary in the intermediating chain.</li> </ul>
Collective Investment Schemes or Discretionary Accounts	<ul style="list-style-type: none"> <li>The direct clients are either the collective investment schemes, discretionary account holders or the asset management companies, as the case may be, which have opened trading accounts with the Relevant Regulated Intermediaries.</li> </ul>
Joint Accounts	<ul style="list-style-type: none"> <li>Where an on-exchange order or off-exchange order is placed from a securities trading account held jointly by two or more persons, a Relevant Regulated Intermediary is required to assign a BCAN to the account and not to the account holders. This BCAN should be distinct from any BCAN assigned to any joint account holder who holds a securities account with the Relevant Regulated Intermediary in his sole name. The BCAN-CID Mapping File containing the CID of all holders of that joint account should be submitted by the Relevant Regulated Intermediary to the SEHK under the BCAN assigned to the joint account.</li> </ul>
Aggregated Orders	<ul style="list-style-type: none"> <li>Aggregated orders are orders which comprise of two or more purchase and/or sell orders of the same security placed by different clients of a Regulated Intermediary for On-Exchange Orders or Off-Exchange Orders. Relevant Regulated Intermediaries should first assign a specific code to the aggregated orders as prescribed by the SEHK and tag such code to the orders when they submit such orders to the SEHK for execution. Relevant Regulated Intermediaries will be required to submit information on each underlying order (including the BCAN for each direct client) of the aggregated orders to the SEHK within the specified timeframe (T+3). This is to enable the tracing of investors' identities within aggregated orders and avoid circumvention of the proposed regime by the use of aggregated orders.</li> <li>In the case of an executed aggregated order, a Relevant Regulated Intermediary which submits (or arranges to submit) the order to the SEHK or carries out the order should also ensure that the BCAN of each client or joint account to which the underlying orders relate are subsequently submitted to the SEHK in accordance with the SEHK's requirements of the SEHK either directly or through another Relevant Regulated Intermediary.</li> </ul>

## Implementing the HK Investor ID Regime Step 2: Assign BCAN to Direct Clients, Tagging of Securities Orders, Accuracy and Timeliness of Information

Under paragraphs 5.6(i) to (k) of Code of Conduct, a number of obligations on Relevant Regulated Intermediaries will be imposed, including:

- Relevant Regulated Intermediaries must implement automated order management systems to ensure that correct and valid BCANs are assigned to direct clients, tagged to clients' On-Exchange Orders or Off-Exchange Orders and included in OE Trade Reporting. The same applies to any specific code assigned by SEHK (e.g. for aggregated orders); and
- Relevant Regulated Intermediaries must ensure the BCANs and the CID they submit to SEHK are accurate and kept up-to-date and they must notify the SEHK when they become aware that any such information has changed, is inaccurate or should otherwise be updated, including where there is a closure of a client account, addition of a new client account, or a change in CID. Relevant Regulated Intermediaries must put in place procedures to require clients to notify the Relevant Regulated Intermediaries of any updates to their CID.

The SFC states in the Consultation Conclusions that there is no pre-validation requirement under the HK Investor ID Regime for the BCAN assigned by a Relevant Regulated Intermediary nor for the BCAN-CID Mapping File submitted by the Relevant Regulated Intermediary. In other words, a Relevant Regulated Intermediary does not need to wait for confirmation that the BCAN or BCAN-CID Mapping File is valid before it tags the BCAN to an order. However, there will be a mechanism on the system to check order inputs to ensure a BCAN is tagged and in the right format (in numerical form and consisting of the right number of digits). Those orders without BCANs or without BCANs in the correct format will be rejected by the system.

In respect of a change of a BCAN, the SFC mentions in the Consultation Conclusions that prior approval from the SEHK will not be required. However, if a change to a BCAN is made after an order is placed but before it is executed, the order will need to be cancelled and re-inputted with the correct BCAN, in which case the order has to line up again. Where a BCAN needs to be changed after an order is executed, the Relevant Regulated Intermediary should file a notification to the SEHK in accordance with its prescribed forms and processes as soon as possible.

The SFC has set out in Appendix B to the Consultation Conclusions various BCAN assignment scenarios to provide greater operational clarity to the industry.

## Implementing the HK Investor ID Regime Step 2: Practical Considerations

In our view, one of the first and foremost practical considerations which Relevant Regulated Intermediaries need to consider is to what extent they would like to – or are able to leverage – the infrastructure of their existing NB Investor ID Regime and replicate such infrastructure to the HK Investor ID Regime.

The SFC notes in the Consultation Conclusions that public feedback was received proposing that the same BCAN be used for an investor which comes under both the HK Investor ID Regime and NB Investor ID Regime. In response to this, the SFC states that a client's BCAN can be the same under the HK Investor ID Regime and the NB Investor ID Regime, provided that the BCAN for the HK Investor ID Regime remains compliant with the requirements set out in the information paper which will be published by the SEHK later to provide more information about the operational logistics of the HK Investor ID Regime (HKEX Information Paper). To distinguish between BCANs assigned by different Relevant Regulated Intermediaries, a Relevant Regulated Intermediary will also be required to insert its CE number as a prefix before the BCAN on the trading system and in the BCAN-CID Mapping File.

Whilst there are some similarities between the HK Investor ID Regime and the NB Investor ID Regime, there are a few crucial differences, including:



- the “in-scope securities” between the two investor identification regimes are completely different and so does the possibility of combination of different direct clients within the same accounts, different BCAN and CID and different BCAN-CID Mapping Files as persons may control different accounts through different structures in order to pursue different investment objectives and strategies;
- it is not clear, at least at this stage, the differences between the cut-off times between the submission of the BCAN-CID Mapping Files under the existing NB Investor ID Regime and the new HK Investor ID Regime. What should the Relevant Regulated Intermediaries do when the two cut-off times do not “sync” – for example, under the NB Investor ID Regime, the SEHK must receive the BCAN-CID files before the prescribed T-1 day cut-off time in light of the pre-trade checking procedures for Northbound trading;
- for the HK Investor ID Regime, the SFC has reflected some of the requirements it will impose on Relevant Regulated Intermediaries in the Code of Conduct (see Step 2 in the paragraph above), but this is not the case for NB Investor ID Regime. It is not clear the rationale for imposing a more stringent standard on Relevant Regulated Intermediaries (e.g. a series of repeated breaches may potentially call the fitness and properness of the Relevant Regulated Intermediaries into question and it is necessary for a Relevant Regulated Intermediary to report material breaches to the SFC under Chapter 12.5 of the Code of Conduct). In our view, a number of the SFC’s amendments are operational in nature and as with all operational set up, it will take time for the financial institutions to upgrade its systems as a whole; and
- paragraph 5.6(k) of the Code of Conduct requires Relevant Regulated Intermediaries to submit accurate BCANs and CID which are kept up-to-date. It is noted that the wording in the finalised paragraph 5.6(k) of the Code of Conduct differs from that in the draft Code of Conduct appended to the Consultation Paper, which now states that Relevant Regulated Intermediaries should put in place measures to require clients to notify them of any updates to their CID. However, under the same paragraph 5.6(k) of the Code of Conduct, Relevant Regulated Intermediaries still have the obligation to “take all reasonable steps to establish that the BCAN and CID which it submits to the SEHK are accurate and kept up-to-date”. It remains to be seen whether such requirement will impose an onerous burden on the Relevant Regulated Intermediaries upon the implementation of the HK Investor ID Regime.

### Implementing the HK Investor ID Regime Step 3: CID

Paragraphs 5.6(n) and (o) of the Code of Conduct set out the specified information and supporting documents relating to CID which Relevant Regulated Intermediaries will need to obtain from direct clients. Information required in respect of CID include (i) the full name of the client as shown in the client’s identity document; (ii) the issuing country or jurisdiction of the identity document; (iii) the identity document type; and (iv) the identity document number.

In respect of the responsibility of Relevant Regulated Intermediaries to ensure CIDs are accurate and kept up-to-date, the SFC states in the Consultation Conclusions that under the new paragraph 5.6(k) of the Code of Conduct, Relevant Regulated Intermediaries should take all reasonable steps to ensure that the client information (including the data constituting the CID) they collect and submit to the SEHK’s data repository is accurate and kept up-to-date. These may include obtaining representations and warranties from their clients as they consider appropriate to assist their verification and maintenance of CID. A Relevant Regulated Intermediary should put in place measures to require its clients to notify it of any updates to the CID. The SFC cautions that as and when a Relevant Regulated Intermediary has actual notice of a change in a client’s CID, it should submit the updated BCAN-CID Mapping File to SEHK’s data repository as soon as practicable, rather than only when the client’s next trade is executed. This is to ensure the integrity of the data in the repository for effective market surveillance.

In addition, the SFC states in the Consultation Conclusions that the Relevant Regulated Intermediary which prepared the BCAN-CID Mapping File is the party responsible for ensuring the BCAN-CID Mapping File’s accuracy under paragraph 5.6(k) of the Code of Conduct. A Relevant Regulated Intermediary which is submitting a BCAN-CID Mapping File on behalf of another Relevant Regulated Intermediary should not alter the file before or upon submitting the file to the data repository.

In respect of the responsibility of submitting the BCAN-CID Mapping File, the SFC clarifies in the Consultation Conclusions that such responsibility rests with Relevant Regulated Intermediaries, not investors. The SFC states that investors will not be penalised if a Relevant Regulated Intermediary fails to submit the BCAN-CID Mapping File by a prescribed time as per the requirements.

Relevant Regulated Intermediaries must ensure that the CID of direct clients are submitted within the designated timeframe, as follows. However, the SFC states in the Consultation Conclusions that it will allow voluntary tagging of BCANs for On-Exchange Orders and Off-Exchange Orders, and OE Trade Reporting (including manual crosses on the SEHK) when the order or trade only relates to odd lots. Where an order is matched with an order comprising a board lot and an odd lot, a BCAN must be tagged to the whole order. In terms of reporting the underlying orders in an aggregated order, a BCAN for each underlying order (i.e. allocated trade), regardless of board lot or odd lot, must be reported in accordance with the form specified by the SEHK.

Client Types	Timeframes
Direct Clients that have opened accounts with Relevant Regulated Intermediaries and have conducted trades through such accounts	These clients should generally be able to submit information within a specified period before the implementation date of the HK Investor ID Regime and in any event at the latest by the day before the trading day.
New clients who wish to open accounts to trade and clients whose accounts have remained dormant since account opening	<p>Where there is an update to the BCAN-CID Mapping File due to on-boarding of new clients (or the closure of a client account or a change in CID information for existing clients), a complete file with the CID of all relevant clients must be uploaded to the data repository on the day an update has been made.</p> <p>For a new client assigned a BCAN on the trade day, the BCAN-CID Mapping File containing the new client's CID can be submitted to SEHK's data repository either before or after the order is submitted, but in any event before a cut-off time on the trading day prescribed by the SEHK and set out in the HKEX Information Paper. This also applies to dormant clients.</p>

The SFC states in the Consultation Conclusions that newly on-boarded clients can trade on the day of account opening and dormant clients can trade on the day when their accounts become re-activated (ie, the day of entering into a trade). In respect of the timing of assignment of BCANs, the SFC mentions that a BCAN can be assigned by a Relevant Regulated Intermediary upon account opening (for a newly on-boarded client) or in preparation for the implementation of the regime (for all existing clients, regardless if they are dormant clients).

Failure to submit the BCAN-CID Mapping File to the SEHK by the prescribed time will not invalidate the orders or trades but may breach the Code of Conduct or contravene the SEHK's Rules of the Exchange.

## Implementing the HK Investor ID Regime Step 4: Obtaining Clients' Consent (Personal Data)

In respect of confidentiality of data submitted to the SEHK and the SFC, the SFC mentions in the Consultation Conclusions that the SFC and SEHK will keep the data only for as long as necessary to perform their statutory functions and will put in place measures to comply with the Personal Data (Privacy) Ordinance (PDPO). The SFC states that information collected under the HK Investor ID Regime is solely for the SFC's regulatory and surveillance purposes and the SEHK's market surveillance and its rules' enforcement. The SFC states that it is not anticipated that information would be disclosed to law enforcement agencies in other jurisdictions.

In particular, regarding access to BCAN and CID information by the SFC and HKEX staff, the SFC states in the Consultation Conclusions that such will be on a strict need-to-know basis and they will have to adhere to the security requirements and measures. The details of the system security measures will be set out in the HKEX Information Paper. The SFC also states that the BCAN tagged to orders and the BCAN-CID Mapping File collected from Relevant Regulated Intermediaries under the HK Investor ID Regime will not be made publicly available.

In respect of the use of a client's personal data which has already been collected by a Relevant Regulatory Intermediary, the SFC notes in the Consultation Conclusions that the use of an individual investor's CID under the HK Investor ID Regime (and the OTC Securities Transactions Reporting Regime) is likely to constitute a new purpose of use, as the two regimes are new initiatives. The SFC understands that a transferor (i.e. a Relevant Regulated Intermediary) should obtain prescribed consent where transfer of personal data would amount to use for a new purpose and in case of doubt about whether personal data is used for a new purpose, the recipient of personal data (which would include the SFC under the regimes) should, as matter of prudent practice, seek the prescribed consent of the data subject before making further use of the data subject's personal data.

### Express Consent from Investors

Under paragraphs 5.6(p) and (q) of the Code of Conduct, on or before the submission of the BCAN-CID Mapping File in respect of an individual client, a Relevant Regulated Intermediary should have obtained from the client written or other express consent in a form and manner in compliance with the SFC's requirements. A record of consent must be kept by the Relevant Regulated Intermediary for as long as the client remains its client and up to at least two years after the client relationship ceases. If such consent cannot be obtained from any client who is a natural person, the Relevant Regulated Intermediary should not submit any BCAN or CID of that client to the SEHK and should only effect sell orders or trades in respect of existing holdings of a listed security (but not buy orders or trades) for that client.

In respect of the form of client consent required under the HK Investor ID Regime, the SFC states in the Consultation Conclusions that no standard form of client consent would be prescribed by the SFC, but the consent must expressly cover the purposes of use of personal data to be specified in a consent circular of the SFC (Consent Circular) to Relevant Regulated Intermediaries. Such specified purposes of use will be substantially similar to the following:



- disclosure and transfer of individual clients' personal data (including CID and BCANs) to the SEHK and/or the SFC, including but not limited to by way of tagging the BCANs to trade orders submitted to the SEHK;
- allowing the SEHK to (i) collect, store, process and use their personal data (including CID and BCANs) for market surveillance and monitoring purposes and enforcement of the Rules of the Exchange of the SEHK; (ii) disclose and transfer such information to the relevant regulators and law enforcement agencies in Hong Kong (including, but not limited to, the SFC) so as to facilitate the performance of their statutory functions with respect to the Hong Kong financial markets; and (iii) use such information for conducting analysis for the purposes of market oversight; and
- allowing the SFC to: (i) collect, store, process and use their personal data (including CID and BCANs) for the performance of its statutory functions including monitoring, surveillance and enforcement functions with respect to the Hong Kong financial markets; and (ii) disclose and transfer such information to relevant regulators and law enforcement agencies in Hong Kong in accordance with applicable laws or regulatory requirements.

The SFC is of the view that the above approach would provide a degree of flexibility in that Relevant Regulated Intermediaries would not have to obtain new consent from clients if both of the following requirements are met: (i) client consent on the use of personal data has already been obtained from these clients; and (ii) the consent expressly includes the purposes of use specified by the SFC in the Consent Circular. In this regard, the SFC mentions that the requirement to obtain consent will not be complied with where the specified purposes of use may only be implied or inferred from the client documentation. Furthermore, client consent need not include the purposes of use as specified by the SFC in a verbatim manner, provided that all of the purposes are covered. However, the SFC states that if the foregoing requirements are not complied with, express client consent will be required in the form required by the SFC.

Regarding the situation in which a client refuses to provide consent for submission of his or her CID under the HK Investor ID Regime, a specific type of BCAN as referred to in the HKEX Information Paper should be used when submitting a sale order of this kind.

Overall, the SFC states in the Consultation Conclusions that Relevant Regulated Intermediaries may also seek professional advice on additional measures and controls which they may need to take to ensure compliance with all applicable data privacy laws and to safeguard the information collected.

## OTC Securities Transactions Reporting Regime

The SFC will introduce the OE Trade Reporting regime for Off-Exchange Trades under which a Regulated Intermediary will have the following reporting obligations to the SFC:

- when the Relevant Regulated Intermediary, whether as principal or agent for a client, makes a transfer of shares in connection with an OTC securities transaction (which the SFC defines as a transaction involving shares which is not conducted by an on-exchange order or reportable as an off-exchange trade within the scope of paragraph 5.6 of the Code of Conduct in respect of which stamp duty is chargeable in Hong Kong and the transaction is not granted stamp duty relief, whether in full or in part, from the Inland Revenue Department (IRD)) (OTC Securities Transaction), it is required to report to the SFC within three Hong Kong trading days after the day (in Hong Kong time) of the transfer; or
- when a Relevant Regulatory Intermediary, whether as principal or agent for a client, deposits or withdraws a physical share certificate, it is required to report to the SFC within three Hong Kong trading days after the day (in Hong Kong time) of the deposit or withdrawal.

In terms of the scope of the OTC Securities Transactions Reporting Regime, upon taking into account public feedback, the SFC states in the Consultation Conclusions that a transfer of shares made in accordance with the terms of a structured product or a derivative (whether listed or not), or for the conversion of a depository receipt into shares and vice versa, is exempted from reporting. This is reflected in paragraph 5.7(c) of the Code of Conduct. The SFC is of the view that the drawback of not having the corresponding information in the OTC Securities Transactions Reporting Regime is manageable as these transactions are sufficiently visible through on-exchange activities. Another reporting exemption is that under paragraph 5.7(d) of the Code of Conduct, where an application for a stamp duty relief has been or will be submitted to the IRD but the relief has not yet been granted, a Relevant Regulatory Intermediary would not be required to report the transfer of shares pending the IRD's determination. However, if the IRD subsequently determines that no stamp duty relief (whether in full or in part) would be granted, the Relevant Regulatory Intermediary should report the share transfer as soon as practicable after being notified of the IRD's determination.

Regarding information which is required to be reported under the OTC Securities Transactions Reporting Regime, in respect of a transfer of shares in connection with an OTC Securities Transaction, information to be reported is set out in paragraphs 5.7(b)(i) to (v) of the Code of Conduct. This includes, for instance, the CE number and role of a Relevant Regulatory Intermediary in making the transfer and a description of the transfer. In respect of a deposit or withdrawal of a physical share certificate, information to be reported is set out in paragraphs 5.7(e)(i) to (iii) of the Code of Conduct. This includes (i) the CE number of the Relevant Regulatory Intermediary, whether it is a deposit or withdrawal of a physical share certificate(s), and whether it is acting as principal or agent; (ii) a description of the deposit or withdrawal of share certificate(s); and (iii) the CID of the client of the Relevant Regulatory Intermediary.

In respect of the SFC's requirement for relevant submissions to be made via the OTC Securities Transactions Reporting Regime submission system, the SFC explains in the Consultation Conclusions that reporting to the SFC directly via the OTCR submission portal would enable the SFC to potentially leverage its centralised submission portal, therefore minimising the need for Relevant Regulated Intermediaries to design a reporting interface. It would also simplify data privacy issues as the SFC hosts the information directly. The SFC therefore is of the view that reporting via the SFC's OTC Securities Transactions Reporting Regime submission portal is better than reporting via the CCASS system of the Hong Kong Exchanges and Clearing Limited.

As regards the appointment of a reporting agent, the SFC mentions in the Consultation Conclusions that there is no restriction in the OTC Securities Transactions Reporting Regime as to the appointment of a reporting agent. Nevertheless, the reporting obligation under the OTC Securities Transactions Reporting Regime will still rest with Relevant Regulated Intermediaries. Such obligation, including the obligation to ensure all information submitted to the SFC is accurate, cannot be delegated to the reporting agent.

Under paragraph 5.7(g) of the Code of Conduct, a Relevant Regulated Intermediary should (i) ensure that all information including CID it submits to the SFC is accurate and (ii) notify the SFC if it becomes aware that any such information is inaccurate or should otherwise be updated. It should also put in place measures to require clients to notify it of any updates to their CID.

As regards express consent under the OTC Securities Transactions Reporting Regime, the SFC states in paragraphs 5.7(h) and (i) of the Code of Conduct that where information relates to individual clients, the Relevant Regulated Intermediary shall have obtained from the client written or other express consent in form and manner in compliance with the SFC's requirements. A record of consent must be kept by the Relevant Regulated Intermediary for as long as the client remains its client and up to at least two years after the client relationship ceases. If such consent cannot be obtained from a client, the Relevant Regulated Intermediary should not submit any CID of that client to the SFC, and it should only effect transfers of shares out of and withdrawals of physical share certificates from that client's account but not transfers of shares or deposits of physical share certificates into that client's account. Further, the SFC states in the Consultation Conclusions that when reporting is made under such circumstances, a special indicator (to be specified in the Technical Document) will need to be submitted instead of the client's CID.

## Implementation timeline

In light of feedback received from the public, the SFC plans to implement the HK Investor ID Regime by the second half of 2022 and the OTC Securities Transactions Reporting Regime by the first half of 2023. The SFC states in the Consultation Conclusions that this is subject to the completion of system testing and market rehearsals. The SFC also intends to issue an implementation circular by September 2021 to provide guidance to the industry on the preparations required under the new regimes and the timeline regarding related matters. The SFC states that the revised amendments to the Code of Conduct will become effective on a date to be determined in line with the above implementation timeline.

In respect of the HK Investor ID Regime, the SFC mentions in the Consultation Conclusions that it will work with the SEHK to provide a system testing period and conduct training sessions for the industry prior to implementation. The SFC will work with the SEHK to streamline the related technical processes with a view to promoting operational efficiencies and reducing manual reporting procedures to the extent practicable. The SFC further states that the SEHK will soon release a document on technical specifications and interfaces to facilitate technical enhancements.

In respect of the OTC Securities Transactions Reporting Regime, the SFC expects to issue an information paper (Technical Document) by the end of 2021 to provide technical details including file specifications, reporting templates and submission channels for the OTC Securities Transactions Reporting Regime submission portal. Moreover, the SFC states that tests by Relevant Regulated Intermediaries of connectivity with the OTC Securities Transactions Reporting Regime submission portal will tentatively be conducted from the third quarter of 2022 when such submission portal is released for trial.

## Conclusion

We support the development and implementation of the HK Investor ID Regime and the OTC Securities Transactions Reporting Regime as we believe that, if successfully designed and implemented, the above regimes will be one of the critical tools for the SFC to enhance its market surveillance capability. It is also in line with the global regulatory development which demands investors to provide more transparency.

The SFC has made various amendments in the finalised paragraphs 5.6 and 5.7 of the Code of Conduct, which may help to allow for greater flexibility as well as reduced operational burden from a practical perspective. In respect of the HK Investor ID Regime, for instance, the SFC has revised the scope of a “client” in the Code of Conduct to the effect that it will not include an investor who is a client of an EP’s overseas affiliate. Further, voluntary tagging of BCANs for odd lots in on-exchange orders and off-exchange trade reporting will be allowed under the HK Investor ID Regime. Moreover, in regards to a change in BCAN, prior approval from the SEHK will not be required. In respect of the OTC Securities Transactions Reporting Regime, the SFC has extended the reporting time from within one to three Hong Kong trading days after the day of transfer, deposit or withdrawal. This is expected to help mitigate the challenges in relation to different time zones or other factors beyond the control of the party submitting a filing. In addition, the SFC has introduced exemptions to OTC Securities Transactions Reporting Regime in the finalised Code of Conduct. In particular, a transfer of shares in connection with an OTC Securities Transaction in respect of which stamp duty is chargeable in Hong Kong will not be reportable if (i) the transaction is granted stamp duty relief (whether in full or in part) from the IRD, or (ii) the transfer of shares is made in accordance with the terms of a structured product or a derivative, or for the conversion of a depository receipt into shares or vice versa.

As regards the implementation timeline for the HK Investor ID Regime and the OTC Securities Transactions Reporting Regime, the SFC has put forward an extended timeline in respect of both regimes, which is more realistic when compared to the timing proposed in the Consultation Paper. It is hoped that the revised timelines will provide sufficient time for the industry to work on the relevant preparation work ahead of the implementation of the new regimes.

However, it remains to be seen how protection of sensitive information and data security will be achieved in practice. For instance, in respect of the HK Investor ID Regime, whilst the SFC mentions in the Consultation Conclusions that access to BCAN and CID information by the SFC and HKEX staff will be on a strict need-to-know basis, details of the system security measures will be set out in the HKEX Information Paper which is yet to be published at this stage. It is hoped that the SFC and other relevant bodies will issue related guidance in a timely manner and offer practical support to market participants where necessary, such that a smooth implementation of the HK Investor ID Regime and the OTC Securities Transactions Reporting Regime can be achieved when they come into effect.

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