

LEGAL UPDATE

Investor ID Model for Northbound Trading

On 30 November 2017 the Hong Kong Securities and Futures Commission (“SFC”) announced that an agreement has been reached with China Securities Regulatory Commission (“CSRC”) on proposals to introduce an investor identification model for Northbound trading under the Mainland - Hong Kong Stock Connect¹ (“Investor ID Model”). Hong Kong Exchange and Clearing Limited (“HKEX”) also published an [Information Paper](#), a [circular](#), a [FAQ](#) and had arranged a [Briefing to Participants on Northbound Investor ID Model](#).

In the SFC announcement, it was expressed that the Investor ID Model is critical to safeguard market integrity and to strengthen the protection of investors in both markets, and that the SFC also aims to implement an investor identification regime to cover all trading on the SEHK in the longer term.

This legal update is intended to shed some light on the key features of Investor ID Model with a particular focus on its implications on asset management companies. For more operational details of the Investor ID Model please refer to HKEX’s [Information Paper](#) and [FAQ](#).

Background

There is an increasing global trend for securities markets regulators to develop an investor identification regime to facilitate more effective market surveillance in line with three stated objectives of the International Organisation of Securities Commissions: 1) protecting investors, 2) ensuring markets are fair, efficient and transparent, and 3) reducing systemic risks.

European and US markets are implementing investor ID regimes as part of their Markets in Financial Instruments Directive II (MiFID II) and Consolidated Audit Trail (CAT) plans.

Mainland adopts a trading and clearing see-through model for its securities markets. All investor’s securities accounts for trading on the Mainland exchanges are linked to the corresponding investors. The securities account numbers must be tagged to all orders submitted to the Mainland exchange which will be carried further till the clearing end of each transaction. Such securities account numbers are also used for a wide range of purposes such as pre-trade checking, market surveillance and foreign shareholding monitoring.

Meanwhile in Hong Kong, only identifiers of the executing brokers are submitted to the Mainland exchanges when Northbound trading is conducted under the Stock Connect. In further strengthening regulatory cooperation for the purpose of more effective market monitoring and surveillance under Stock Connect, the SFC and CSRC have agreed to introduce an Investor ID Model in Hong Kong for Northbound Trading, scheduled for implementation in the third quarter of 2018. A reciprocal Southbound investor identification regime will be implemented shortly after the Northbound Investor ID Mode has been implemented.

¹ Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, both provide for mutual stock market access between Hong Kong and the Mainland.

Key Features of the Investor ID Model

The Investor ID Model will be applicable to all Exchange Participants (“EPs”), including China Connect Exchange Participants² (“CCEPs”) and Trade-through Exchange Participants³ (“TTEPs”). They will be required to:

- 1) assign a unique number named “Broker-to-Client Assigned Number” (“BCAN”) to each of their Northbound trading clients;
- 2) provide BCANs and the corresponding “Client Identification Data” (“CID”) – the BCAN-CID mapping files to Stock Exchange of Hong Kong (“SEHK”) before 3pm on T-1 day. SEHK will send the information to Mainland exchanges;
- 3) tag the BCAN to every Northbound order on a real-time basis on T-day.

The BCANs and CIDs are to be used for trading and regulators’ market surveillance, and will not be used in clearing and settlement nor will they be available for public viewing. No central registration is required for the investors.

It should be noted that both BCAN and CID of individual investors will be personal information as defined under the Hong Kong Personal Data (Privacy) Ordinance. EPs should review and make appropriate arrangements including obtaining their clients’ prescribed consent in order that they can disclose their clients’ information to SEHK and the Mainland exchanges. If no prescribed consent is obtained from client, the EPs can only input Northbound sell orders for such client.

The Mainland exchanges will conduct market surveillance based on the BCANs. If the Mainland exchanges identify any abnormal activity in the orders of a specific BCAN, the Mainland exchanges may take measures in accordance with the relevant laws and regulations, including rejecting orders bearing the same BCAN.

BCAN

BCAN is a unique number assigned by a broker to its client. It should be in the format of 10-digit numeric data field, ranging from 100 to 9,999,999,999. Once assigned, it cannot be changed or reused, unless it is approved by HKEX under exceptional circumstances.

Each BCAN should be unique, able to identify clients and distinct from internal client account number. It should be noted that every BCAN shall not bear any obvious link to a client’s identity and it shall be kept confidential – which means that BCANs should not be shown on any general enquiry screens, reports or statements (even including statements issued to the relevant client). BCAN information and accessibility, even within the CCEPs and TTEPs should be strictly restricted to need-to-know basis.

² China Connect Exchange Participants (CCEPs): exchange participants registered with SEHK as China Connect Exchange Participants

³ Trade-through Exchange Participants (TTEPs) : exchange participants registered with SEHK to conduct trading in Connect Securities through CCEPs for the account of their clients.

CID

For each client of an EP, the CID provided to the SEHK shall include the following four elements:

Individual Natural Person Client	Institutional /Corporate Client
Name: the client's full name as shown on the identity document	Name: the entity's name as shown on the certificate of incorporation or Legal Entity Identifier ⁴ (LEI)
ID issuing country	ID issuing country
ID type: ID card, passport, or any other official identity document	ID type: certificate of incorporation or LEI
ID Number	ID number: certificate number or LEI

The BCANs would hence relate to each underlying client account holder trading through an EP, CCEP or TTEP, whether an individual natural person investor or a corporate entity investor. An individual account holder would need to be assigned a specific BCAN which would be different from the BCAN to be assigned for a joint account which he/she holds with another individual. Where an investor trades through multiple EPs, such investor may have different BCANs assigned through respective EPs, however the investor's CID would be identified with each BCAN.

BCAN Tagging – Asset Management Companies / Funds

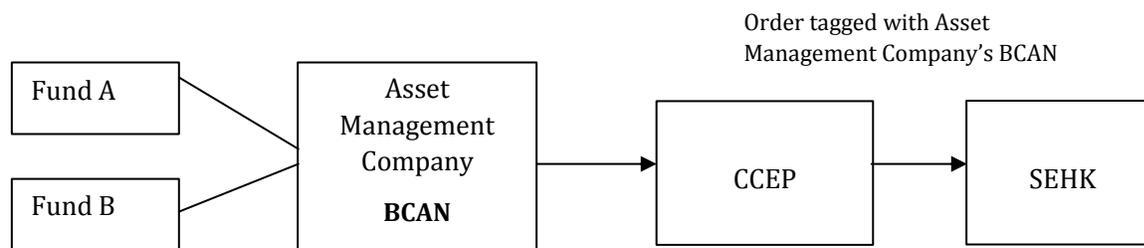
EPs are required to tag Northbound trading orders with the corresponding BCANs on a real-time basis when submitting order to SEHK on T-day.

For Northbound trading orders from an asset management company managing multiple funds, an EP shall tag the BCAN to the legal entity for which it opens the Northbound trading account, as outlined in the scenarios and illustrations below.

- A. If the Northbound trading account is opened under the name of the asset management company, the BCAN shall be tagged to the asset management company.

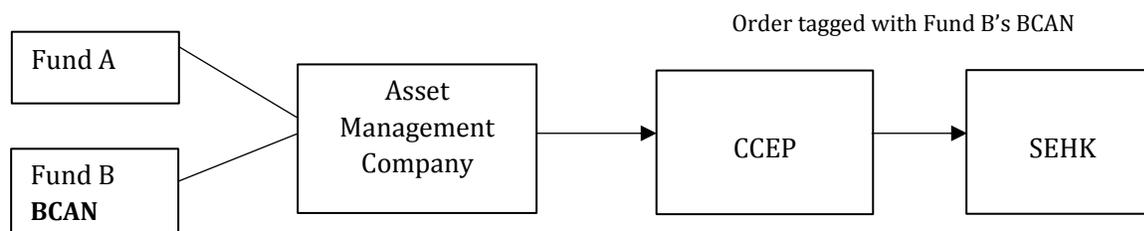
Example: A Northbound trading account is opened with a CCEP under the name of the asset management company

⁴ A 20-character, alpha-numeric code, to identify entity that engages in financial transactions issued by “Local Operating Units” of the Global LEI System.



B. If the Northbound trading account is opened under the name of an individual fund, the BCAN shall be tagged to that particular fund.

Example: A Northbound trading account is opened with a CCEP under the name of Fund B



As the BCAN tagging depends on the account opening arrangement with the EPs, it is technically possible for an asset management company to open accounts with EPs under its own name as well as under its funds' names. In this way the asset management company will have the choice to place the Northbound trading orders either at the fund level or at the asset management company level.

Placing Northbound trading orders using a fund-specific BCAN may be preferable in that if the BCAN is rejected by the Mainland exchanges or that the corresponding trading account is suspended for any reason, this will not affect the Northbound trading orders submitted for other funds managed by the same asset management company. In contrast, if all Northbound trading orders are submitted on the asset management company level, once its BCAN gets rejected by the Mainland exchanges, the Northbound trading orders for all of its funds will be affected.

As the BCANs and CIDs are for trading and will not be used in clearing and settlement, the Investor ID Model shall affect trading only but not the clearing and settlement arrangements in place.

Implementation and Technology

There will be market rehearsal and system testings prior to actual implementation of the Investor ID Model which is expected to take place in Q3 2018.

It is SFC's stated intention that the Investor ID Model shall in the future also apply to all trades on SEHK. As similar models become introduced in US and European markets as well, financial markets around the world would enter a new phase of increased transparency on the underlying investors and traders of securities markets.

The increased transparency and volume of data for tracking and reporting bottom-up and for surveillance top-down would no doubt require use of digitisation and technology, which market exchanges as well as market participants should continue to review on the needs, systems, risks, opportunities and challenges.

Contact Details

If you like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual contact at our firm.

Vivien Teu

Managing Partner

Vivien Teu & Co LLP

Tel: (852) 2969 5300 / 2969 5316

vivien.teu@vteu.co

This publication is for general guidance only and is not intended to provide legal advice in any specific case. We expressly disclaim any liability for the consequences of action or non-action based on this publication. All rights reserved. © Vivien Teu & Co LLP – December 2017