

SFC proposes new investor ID regime

SFC issues consultation on proposals to implement investor identification regime at the trading level for the securities market and an OTC securities transaction reporting regime for SEHK-listed shares

On 4 December 2020, the Hong Kong Securities and Futures Commission (the "**SFC**") issued a [consultation](#) on proposals to implement a new investor identification regime at the trading level (as opposed to the ownership level). If the proposals are implemented, regulated intermediaries¹ ("**RI**") may need to make changes to their trading systems. The proposed regime is expected to work independently from the investor identification regime launched on 26 September 2018 for Northbound trading under Stock Connect.

The regime is intended to facilitate more timely and effective market surveillance on the one hand, and reduce ongoing compliance costs of RIs in dealing with SFC enquiries about client identities on the other. As things currently stand, the SFC has had to resort to issuing notices under s.181 of the Securities and Futures Ordinance in order to investigate and obtain more information on orders and the identity of underlying clients, which is costly and time-consuming for both the SFC and affected RIs. The regime is said to be in line with developments in other jurisdictions such as the United States, Europe, Australia, Singapore and Mainland China.

An overview of the new proposals, which can be divided into 2 parts, is explored in this article:

- 1) in respect of (i) on-exchange orders for securities listed on the Stock Exchange of Hong Kong ("**SEHK**") and (ii) any off-exchange trade for listed securities that is reportable to the SEHK,

there will need to be an assignment of broker-to-client assigned numbers ("**BCAN**"), and the submission of BCAN and up-to-date client identification data ("**CID**", together with the BCAN information, the "**BCAN-CID Mapping File**") to the SFC. The ultimate goal is to extend this regime to the exchange-traded derivatives market in the future; and
- 2) when an RI (i) makes a transfer of SEHK-listed ordinary shares or real estate investment trusts ("**REITs**") that are neither recorded by SEHK as on-exchange orders nor required to be reported to the SEHK as off-exchange trades, in respect of which stamp duty is chargeable ("**OTC Securities Transactions**"), or (ii) deposits or withdraws any physical share certificate (to the extent that they relate to SEHK-listed ordinary shares or REITs) ("**Deposit or Withdrawal of Physical Share Certificates**"),

certain information needs to be submitted to the SFC.

If implemented, new paragraphs 5.6 and 5.7 will be added to the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC to reflect the new regime.

An overview of part (a) of the regime is set out below:

- 1) RIs need to assign a BCAN to each "**Relevant Client**". In cases where an RI is dealing directly with a client, that client is the Relevant Client. But where a chain of intermediary RIs is involved, it may be less clear who the Relevant Client is, though there are detailed rules to govern who the Relevant Client should be, how each RI is to assign a BCAN, who is to obtain CID, and which RI is to submit the relevant information to the SFC. It is important to note that the purpose of identifying the Relevant

¹ This refers to a "licensed corporation" or a "registered institution", each as defined under section 1 of Schedule 1 to the Securities and Futures Ordinance.

Client is to identify the "legal person who has control and responsibility over the issuance of the relevant order", and that person "[might] not be the ultimate beneficial owner of the trade".

- 2) The submission of the BCAN-CID Mapping File for each client is a one-off exercise (subject to the updating of the underlying CID). On the other hand, the order information for each and every trade that is submitted to SEHK needs to include the BCAN.
- 3) BCANs are already assigned to clients in respect of Northbound trading under Stock Connect. RIs are free to assign the same or a different BCAN for the purposes of part (a) of the regime.
- 4) There are specific rules regarding BCANs for proprietary trading, orders placed through affiliates or a chain of affiliates, discretionary accounts, aggregated orders and joint accounts.
- 5) In terms of Relevant Clients who are individuals, CID comprises of:
 - a) full name;
 - b) ID document issuing country;
 - c) ID document; and
 - d) ID document number.
- 6) To avoid overloading the SFC's systems, RIs will be able to upload the CID of its existing clients to the SFC up to 9 months before the launch of part (a) of the regime.
- 7) Prescribed consent must be obtained from Relevant Clients (whether new or existing clients) regarding the collection of CID and the associated new purpose, use and transferees. Changes will likely need to be made to an RI's privacy policy statement and/or personal information collection statement.

An overview of part (b) of the regime is set out below:

- 8) In terms of each OTC Securities Transaction, the RI must submit the following information to the SFC:
 - a) stock name and code of the shares transferred;
 - b) transaction price per share;
 - c) quantity of shares transfer handled by the reporting RI;
 - d) quantity of shares of the transaction;
 - e) share transfer date;
 - f) transaction date;
 - g) CE number of the reporting RI and role of the reporting RI in the transfer;
 - h) CE number and full name of the counterparty corporation to the reporting RI; and
 - i) CID of the transferor/transferee (where that person is a client of the reporting RI).
- 9) In terms of each Withdrawal or Deposit of Physical Share Certificates, the RI must submit the following information to the SFC:
 - a) stock name and code of the shares to which the physical share certificates relate;
 - b) quantity of shares referenced in the physical share certificates;
 - c) deposit/withdrawal date;

- d) CE number and role of the reporting RI; and
 - e) CID of the client on whose behalf the physical certificates are held by the RI.
- 10) As with part (a) of the regime, there will be similar data privacy concerns owing to the collection and use of personal information.

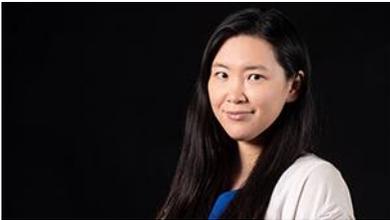
Conclusion

As mentioned in our opening paragraph, if the proposals are implemented, RIs may need to make changes to their trading systems. This will necessitate new staff training, changes to IT systems and updating of an RI's terms and conditions and privacy policy. There might also be increased operating expenses, which, if is the case, will need to be considered on a business level.

It is important to note that the proposals are distinct and additional to the "Client Identity Rule", which generally speaking is the SFC's policy requiring certain intermediaries to embed a contractual right in their client agreements for the client to identify to the intermediary the ultimate investor of any trade in exchange-traded derivatives, such that the intermediary can pass this information on to the SFC and/or the HKEX within two business days.

The substantial nature of the regime is reflected in the 9-month CID upload period which the SFC is expected to roll out in advance of the regime coming into force. RIs and other interested market participants are reminded to keep abreast of changes in this area and to submit any feedback they may have to the SFC by 4 March 2021.

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